92-1929

No. _____

FILED
JUN 01 1993
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

October Term, 1992

DALE L. CARTER, DAVID JOHNSON, FRED EMERY, and JAMES R. STRAW, on behalf of all similarly situated in the State of Idaho, Petitioners

v.

JESSE BROWN, or his successor, Secretary of the Department of Veterans Affairs

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Counsel of Record
David A. Leen
Member of the Supreme Court Bar
Counsel for Petitioners
520 E. Denny
Seattle, WA 98122
(206) 325-6022

ABCD Legal Printers, Seattle, Washington

QUESTIONS PRESENTED FOR REVIEW

Idaho's foreclosure laws bar deficiency judgments following non-judicial foreclosures of purchase-money mortgages on single-family homes unless the lender obtains a judicial confirmation of the fair value of the property within 90 days from the foreclosure. Unless this procedure is followed, the borrower is not liable -- either to a lender or to a guarantor -- for any such deficiency. Many thousands of Idaho veterans purchased homes with loans guaranteed by the Veterans Administration pursuant to the Home Loan Guaranty Program, 38 U.S.C. §§ 3701-3733. Thousands have suffered foreclosures with resultant deficiencies stated by the VA to be in excess of $40,000,000. The VA claims entitlement to those deficiencies under its program. The questions presented are:

1. Whether *United States v. Shimer*, 367 U.S. 374, 81 S.Ct. 1554, 6 L. Ed. 2d 908, (1961) requires that veterans be denied the benefits of the Idaho foreclosure law when the VA directs that state law be used to foreclose VA guaranteed loans.

2. Whether, as the District Court held, this Court's more recent decision in *United States v. Kimbell Foods*, 440 U.S. 715, 99 S.Ct. 1448, 59 L. E.d. 2d 711, (1979), rather than *Shimer*, as the Ninth Circuit Court of Appeals held, provides the appropriate standard for determining whether Idaho's law has been displaced by a federal regulation granting the VA a general right of indemnity.

LIST OF PARTIES

The caption contains the names of all included parties to the proceedings below, but the matter has been certified as a class action pursuant to F.R.Civ.P. 23(b)(2) and contains approximately 5,000 individual veterans.

TABLE OF CONTENTS

Opinions Below 1

Jurisdiction 1

Statutes and Regulations Involved 2

I. Statement of the Case 4

A. Introduction 4

B. The Material Facts 4

C. Idaho Foreclosure Law 5

D. The Decisions Below 6

II. Summary of Argument 8

III. Argument for Allowance of Certiorari 11

A. Important Questions of Federalism 12

1. The District Court Correclty Applied the *Kimbell Foods* Test as Set Forth in the *Whitehead* Opinion 22

2. Idaho Law Has Been Properly Adopted by the District Court as the Federal Rule of Decision of Idaho 41

B. Conflict and Confusion in the Circuit Court as to the Appropriate Preemption Test . . 47

IV. Conclusion 53

APPENDICES

Appendix A . . . . . .
Whitehead v. Derwinski, 904 F.2d 1362 (9th Cir. 1990)

Appendix B . . . . . .
Carter v. Derwinski, 758 F. Supp. 603 (D. Idaho 1991)

Appendix C . . . . . .
Carter v. Derwinski, 987 F.2d 611 (9th Cir. 1993)

TABLE OF AUTHORITIES

Table of Cases

Bowles v. Seminole Rock & Sand Co., 325 U.S. 410, 414, 65 S. Ct. 1215, 1217, 89 L.Ed. 1700 (1945) . . . 34

Capital Cities Cable, Inc. v. Crisp, 467 U.S. 691, 699 (1984). 27, 53

Cepollone v. Liggett Group, Inc., 112 S. Ct. 2608, 2617 (1992) 25

Cf., F.T.C. v. Fred Meyer, Inc., 390 U.S. 341, 88 S. Ct. 904, 19 L. Ed. 1222 (1968) 37

Clark v. Portland General Elec. Co., 111 F.2d 703 (9th Cir. 1940) 37

Connelly v. Derwinski, 921 F.2d 129 (9th Cir. 1992) 26

Davis v. Derwinski, 961 F.2d 603 (7th Cir. 1992) 50

Dupnik v. United States, 848 F.2d 1476, 1481-85 (9th Cir. 1988) 17, 29, 49

English v. General Electric Co., 110 S. Ct. 2270 (1990) 28

Fidelity Federal Savings and Loan Association v. de la Cuesto, 458 U.S. 141, 153, 102 S. Ct. 3014, 3022, 73 L.Ed.2d 664 (1982) 26, 27, 40, 53

Frazier v. Neilson & Co., 769 P.2d 1111, 1114 (Idaho 1989). 5

Great S.W. Life Ins. Co. v. Frazier, 860 F.2d 896, 900 (9th Cir. 1988) 29, 48

Hillsborough County v. Automated Medical Labs, 471 U.S. 707, 714-16, 85 L.Ed.2d 714, 105 S. Ct. 2371 (1985) 25, 27, 53

Jones v. Turnage, 699 F.Supp 795 (N.D. Cal. 1988) 49

Kamen v. Kemper Financial Services, 111 S. Ct. 1711, 1718, n. 5 (1991) 8, 9, 16, 25

McNight v. United States, 259 F.2d 540 (9th Cir. 1958) 30

Pullman Standard v. Swint, 456 U.S. 273 (1982). 4

Rank v. Nimmo, 677 F.2d 692, 697 (9th Cir.), *cert denied* 459 U.S. 907 (1982) 23

Ruse v. Belcher, 79 Idaho 473, 321 P.2d 210 (1958) 5

Sitton v. United States, 413 F.2d 1386 (5th Cir. 1969) *cert denied* 397 U.S. 988 (1970) 30

United States v. Brosnan, 363 U.S. 237, 251-52 (1960)8, 11, 20

United States v. Church, 837 F. Supp. 1494 (N.D. Ind. 1989) 34

United States v. Crain, 589 F.2d 996, 1000 (9th Cir. 1979). 29

United States v. Davis, 961 F.2d 603 (7th Cir. 1992). 13

United States v. Ellis, 714 F.2d 953, 956-57 (1983). 29, 39

United States v. Haddon Haciendas Co., 541 F.2d 777, 784, n. 8 (9th Cir. 1976) 24

United States v. Irby, 618 F.2d 352, 335 (5th Cir. 1980). 50

United States v. Kimbell Foods, 440 U.S. 715, 99 S.Ct. 1448, 59 L. E.d. 2d 711, (1979) 7, 8, 15, 16, 24, 30, 39, 44, 47

United States v. Little Lake Misere Land Co., 412 U.S. 580, 604 (1972) 17

United States v. MacKenzie, 510 F.2d 39 (9th Cir. 1975). 29

United States v. Murdoch, 627 F. Supp. 272 (N.D. Ind. 1986) 34

United States v. Pastos, 781 F.2d 747 (9th Cir. 1986) . 29, 39

United States v. Shimer, 367 U.S. 374 (1961) 7, 9, 23, 26, 30, 33, 49

United States v. SKA Assoc., 600 F.2d 513, 516 (5th Cir. 1979) 11, 51

United States v. Tacoma Gravel, 376 F.2d 343, 344 (9th Cir. 1967) 20

United States v. Vallejo, 660 F. Supp. 535, 539 (W.D. Wash. 1987) 34, 40, 42

United States v. Warford, 791 F.2d 1519 (11th Cir. 1986). 20

United States v. Whitney, 602 F. Supp. 722 (W.D.N.Y. 1985) 34, 40

United States v. Yazell, 382 U.S. 341, 86 S. Ct. 500, 15 L.Ed.2d 404 (1965) 8, 16, 17, 30, 42

Vail v. Derwinski, 946 F.2d 589 (8th Cir. 1991). 13

Victory Highway Village, Inc. v. Weaver, 634, F.2d 1099 (8th Cir. 1978) 50

Whitehead v. Derwinski, 904 F.2d 1362 (9th Cir. 1990) 7, 10, 22, 25, 30, 32, 44

Wisconsin Public Intervenor v. Mortier, 111 S. Ct. 2476 (1991). 28

Wilson v. Omaha Indian Tribe, 442 U.S. 653, 99 S. Ct. 2529, 61 L.Ed.2d 153 (1979) 8, 17

Statutes

38 U.S.C. §§ 3701-3733 1

28 U.S.C. 1254(1) 1

38 U.S.C. Chapter 37 . . . . . 3, 19

38 U.S.C. § 3732 18

38 U.S.C. § 1801 38

38 U.S.C. § 1331 1

38 U.S.C. § 1346 1

38 U.S.C. § 501(a) 2

38 U.S.C. § 3720(a)(6) 3, 8, 36

38 U.S.C. § 3732(a) 3

38 U.S.C. § 3703(e) 24

Administrative Regulations

38 C.F.R. 36.4323(e) 3, 16, 19, 28, 31 33, 34, 36, 37, 53

38 C.F.R. 36.4320(f) 3, 9, 31

38 C.F.R. § 36.4324(f) 3, 5, 9, 31

38 C.F.R. § 36.4320 . . . . . 14, 25, 27, 32, 44, 45, 46, 47

38 C.F.R. § 36.4315(b)(2) 32

38 C.F.R. § 36.4319 . . . . . 32, 35

38 C.F.R. § 36.4323(c) 32

Other Authorities

Alexander, *Federal Intervention in Real Estate Foreclosure: Preemption and Federal Common Law*, 71 N.C. Law Review 295, 340 ff. (1993) 28, 48

Clauretie, *"State Foreclosure Laws, Risk Shifting, and The Private Insurance Industry"*, 56 J. Risk & Ins. 544 (1989). 15

Dietrich, *The Montana Judicial and Non-Judicial Foreclosure Sale*, 49 Mont. L. Rev. 285 (1988) 15

Meador, *"The Effects of Mortgage Laws on Home Mortgage Rates*, 34 J. Econ. & Bus. 143 (1982) 15

Nelson and Whitman, *Real Estate Finance Law*, (West.2d Ed. 1985) 12, 49

Platt, *Deficiency Judgments in Oregon: Growing Disparities Among Functional Equivalents*, 23 Willamette L. Rev. 37 (1987) 15

Schill, *"An Economic Analysis of Mortgagor Protection Laws"*, 77 Va. Law Rev. 489 (1991) 15

OPINIONS BELOW

The opinion of the United States District Court for the District of Idaho (Appendix B) is reported at 758 F.Supp. 603. The opinion of the United States Court of Appeals for the Ninth Circuit (Appendix C) is reported at 987 F.2d. 611.

JURISDICTION

The judgment of the Court of Appeals was entered on March 4, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1). The District Court had jurisdiction based upon 28 U.S.C. 702 and 38 U.S.C. 3720(a) (waiver of sovereign immunity), 28 U.S.C. 1331 and 1346.

STATUTES AND REGULATIONS INVOLVED

1. Idaho Code §45-1512 (1977) states: *Money Judgment -Action seeking balance due on obligations*:

> At any time within 3 months after any sale under a deed of trust, as hereinbefore provided, a money judgment may be sought for the balance due upon the obligation for which such deed of trust was given as security, and in such action the plaintiff shall set forth in his complaint the entire amount of indebtedness which was secured by such deed of trust and the amount for which the same was sold and the fair market value at the date of sale, together with interest from such date of sale, costs of sale and attorney's fees. Before rendering judgment the court shall find the fair market value of the real property sold at the time of sale. The court may not render judgment for more than the amount by which the entire amount of indebtedness due at the time of sale exceeds the fair market value at that time, with interest from date of sale, but in no event may the judgment exceed the difference between the amount for which such property was sold and the entire amount of the indebtedness secured by the deed of trust.

2. 38 U.S.C. 501(a) provides in relevant part:

> The Secretary has authority to prescribe all rules and regulations which are necessary or appropriate to carry out the laws administered by the Department and are consistent with those laws. . . .

3. 38 U.S.C. 3720(a)(6) provides in relevant part:

The acquisition of such property [by foreclosure, etc.] shall not deprive any state or political subdivision thereof of its civil...jurisdiction of, on or over such property...or impair the rights under the state or local law of any persons on such property.

38 U.S.C. 3732(a) provides:

"[T]he administrator may . . . pay to [the lender] the guarantee not in excess of the pro rata portion of the amount originally guaranteed. If the administrator makes such a payment, the administrator shall be subrogated to the right of the holder of the obligation to the extent of the amount paid on the guarantee."

4. 38 C.F.R. 36.4323(e) provides:

Any amounts paid by the Administrator on account of the liabilities of any veteran guaranteed or insured under the provisions of 38 U.S.C. Chapter 37 shall constitute a debt owing to the United States by such veteran.

5. 38 C.F.R. 36.4320(f):

If a minimum bid is required under applicable State law, or decree of foreclosure or order of sale, or other lawful order or decree, and; (i) Such minimum bid exceeds an amount which has been specified by the Administrator under paragraph (a)(1) of this section; and (ii) The holder acquires the property at the liquidation sale for an amount not exceeding the amount legally required; the holder may elect to convey the property to the Administrator pursuant to paragraph (a)(1)(ii)(A) of this section. The amount bid

> at the sale or the total indebtedness, whichever is less, shall govern instead of the specified amount and for the purpose of determining the Administrator's liability under loan guaranty.

I. STATEMENT OF THE CASE

A. INTRODUCTION

In this case, after taking advantage of Idaho's inexpensive and streamlined non-judicial foreclosure process, the VA is asking this court to excuse it from compliance with an important feature of Idaho law which requires, as a *quid pro quo* for this benefit to the creditor, that a judicial determination of value and any resulting deficiency be sought within 90 days following the non-judicial foreclosure sale. Idaho Code § 45-1512.

B. THE MATERIAL FACTS

This case was decided by the District Court on cross motions for summary judgment based upon largely stipulated (or uncontested) facts. The issues decided involved pure questions of law and this court reviews this case de novo. *Pullman Standard v. Swint*, 456 U.S. 273 (1982).

C. IDAHO FORECLOSURE LAW

The Idaho Deed of Trust Act was passed in 1957 allowing creditors an expedited process as an alternative to the more costly judicial foreclosure which had been the exclusive means of foreclosure in Idaho prior to that time. *See*, Idaho Code § 6-101, *et. seq*. *See generally, Ruse v. Belcher*, 79 Idaho 473, 321 P.2d 210 (1958). Under Idaho law, the right to a deficiency judgment in addition to foreclosure is preserved by judicial foreclosure or by initiating a judicial determination of fair value within 90 days after foreclosure by advertisement and sale pursuant to Idaho Code § 45-1512. Failure to foreclose judicially, or to initiate a fair value hearing pursuant to Idaho § 45-1512, bars recovery of a deficiency. Idaho Code § 6-101; § 45-1503; *Frazier v. Neilson & Co.*, 769 P.2d 1111, 1114 (Idaho 1989). The VA has the ability to direct Idaho lenders as to the method of foreclosure. 38 C.F.R. § 36.4324(f).

In this case, the VA has either explicitly directed or allowed lenders to foreclose under the non-judicial procedure to

obtain the advantages of low cost and minimal delay in the recovery of the security. Thereafter, however, neither the VA nor lenders have sought the fair value hearing as required by Idaho law. Even though the VA could have--but failed--to direct Idaho lenders to comply with Idaho foreclosure procedures which would preserve the right to a deficiency, it nevertheless claims the right to collect deficiencies from Idaho veterans whose VA loans have been foreclosed. Without any hearing or court proceeding of any kind, the VA has attempted to collect, years later, the deficiencies through a variety of devices including withholding from tax refunds, offsetting against disability, pension, education, and other VA benefit payments, and by assigning the claims to collection agencies.

D. THE DECISIONS BELOW

The District Court granted the veterans' motion to certify this case as a class action, and granted summary judgment in favor of plaintiffs following this court's ruling in *United States v.*

Kimbell Foods, Inc., 440 U.S. 715, 99 S. Ct. 1448, 59 L.Ed.2d 711 (1979), as applied by the Ninth Circuit in a factually identical case, *Whitehead v. Derwinski*, 904 F.2d 1362 (9th Cir. 1990). The Ninth Circuit reversed en banc by a closely divided court, and overruled the recent *Whitehead* application of *Kimbell Foods* and, without analysis of circuit precedents or *Kimbell Foods*, held that the VA need not ever comply with state laws that in any way impede its indemnity right. The panel noted that the *Whitehead*/*Kimbell Foods* rationale had "intuitive appeal" in that it was fair for the VA to recognize the "*quid pro quo*" involved in the use of the non-judicial foreclosure alternative". 987 F.2d at 614. The panel concluded that notwithstanding this fairness and sensibility, this court's ruling in *U.S. v. Shimer*, *supra*, precluded applying any state law that would limit the VA's right to seek indemnity. The court held that these laws, designed by the states to balance the rights of debtors and creditors alike, are "irrelevant". *Id.* at p. 616. Four judges dissented, distinguishing *Shimer* and finding that the VA, in choosing the method of state

foreclosure laws, which precludes a deficiency, released the veterans from liability from indemnity, as the *Whitehead* court had held. *Id.* at 617 ff.

II. SUMMARY OF ARGUMENT

The District Court correctly decided this case and should be affirmed:

First, authorities abound supporting the proposition that federal interests can be subjected to state laws that limit or even bar federal claims. *United States v. Brosnan*, 363 U.S. 237, 251-52 (1960); *United States v. Yazell*, 382 U.S. 341, 86 S. Ct. 500, 15 L.Ed.2d 404 (1965); *United States v. Kimbell Foods*, 440 U.S. 715, 99 S.Ct. 1448, 59 L. E.d. 2d 711, (1979); *Kamen v. Kemper Financial*, 111 S.Ct. 1711 (1991). The Ninth Circuit has confused *rights* (which are conceded) and *remedies* (which Congress has declared are to be pursued in state foreclosure actions). 38 U.S.C. 3720(a)(6).

Second, in the area of real estate financing, there is even a stronger presumption that state law is to be adopted. *Wilson v.*

Omaha, 442 U.S. 653 (1979); *Kamen v. Kemper Financial*, 111 S.Ct. 1711 (1991).

Third, all state foreclosure laws have some effect upon the VA's claims. For example, the length of time necessary to foreclosure is a feature of state law that results in direct losses to the lender and ultimately the VA. In Washington, the non-judicial foreclosure sale cannot occur sooner than 190 days from default, in contrast to California where the home can be recovered in 90 days. RCW 61.24. The VA must not ignore this aspect of state law as "irrelevant".

Fourth, the District Court and the dissent in the Ninth Circuit decision properly limited the application of *U.S. v. Shimer*, because of developments in preemption law.

Fifth, VA regulations now reflect congressional intent that state law minimum bid requirements can control the VA's ultimate liability. 38 C.F.R. 36.4320(f). Limitations on deficiencies, redemption rights, upset price protections, and other aspects of state law are functional equivalents.

Sixth, in *Whitehead v. Derwinski*, the Ninth Circuit properly analyzed the VA's indemnity rights vis-a-vis integral remedies in state foreclosure law. That ruling was properly applied by the District Court in this case. In *Whitehead*, the court did not find that the VA indemnity right was "second fiddle" to the subrogation right, but rather used the *Kimbell Foods* test to avoid creating a conflict between state and federal law. The holding in *Whitehead* required the VA to use appropriate state law remedies that were available by subrogation before resorting to indemnity that would violate important portions of state law which were not necessary to the accomplishment of VA program objectives. The Ninth Circuit, in *Carter*, has rejected well-developed state rules which create loss of predictability and do not create federal uniformity (all state foreclosure laws are different). Under the Ninth Circuit *Carter* rule, a homeowner in Washington would lose redemption rights, homestead rights, and judicial due process solely to give the VA a right to collect more money from a veteran who has already lost his or her home. In judicial

foreclosure states, though, even veterans would presumably have the redemption rights when a deficiency is obtained, because they are part of the process. Veterans are now, ironically, better off in those 25 states where non-judicial remedies are not available as they remain in possession of their homes longer, and have judicial supervision (due process).

Finally, when the VA acts as a market participant (rather than a market regulator), it should fare no better nor worse than private creditors. See, *United States v. Brosnan*, 363 U.S. 237, 251-52 (1960); *United States v. SKA Assoc.*, 600 F.2d 513, 516 (5th Cir. 1979).

III. ARGUMENT FOR ALLOWANCE OF CERTIORARI

This court should grant the petitioners' application for certiorari for at least two reasons: (1) Important questions of constitutional and state law are involved which would affect hundreds of thousands of veterans across the nation; and (2) the Circuit Courts of Appeal (and District Courts) have had difficulty

applying the *Kimbell Foods* test; there are conflicts among various lower courts.

A. IMPORTANT QUESTIONS OF FEDERALISM

This class action involves approximately $40 million in VA deficiency claims asserted by the government against approximately 7,000 veteran class members; these claims would be barred or limited if Idaho foreclosure law were applied. Moreover, most states in the nation have some form of debtor protections in their foreclosure laws, particularly when non-judicial remedies are authorized, such as redemption rights, upset price protection, fair value determination, anti-deficiency provisions, etc. *See*, Nelson & Whitman, *Real Estate Finance Law* (West 2nd. Ed. 1985) §8.4. The Idaho Deed of Trust Act is similarly the result of a legislative balancing of lenders' and borrowers' rights; upon non-judicial foreclosure, the lender (and the VA) has already obtained the benefits of the non-judicial procedure but now does not want to pay the costs.

Any state, including Idaho, has an extremely strong interest in its law relating to real property.[1] Idaho's act was designed to benefit lenders by giving them a speedier, less expensive remedy than judicial foreclosure of mortgages. The impetus for its passage came from banks, mortgage companies, and institutional investors.

The VA currently is asserting approximately $1 billion nationwide in deficiency claims against hundreds of thousands of veterans, much of which would be either mitigated or barred by various state law protections. The VA contends that it can disregard any of these various protections if its indemnity claims are impaired.

---

[1]This important state interest prompted the Attorney General of Washington to file an amicus curiae brief in *Whitehead*, and, counsel is informed, to support this petition. It was prompted the Attorney General of Wisconsin to support the veterans in identical class action appeals by the government of *United States v. Davis*, 961 F.2d 603 (7th Cir. 1992) (now pending in Wisconsin), and the Minnesota Attorney General to support the veterans in *Vail v. Derwinski*, 946 F.2d 589 (8th Cir. 1991) (now pending in the District Court of Minnesota on remand).

Although Congress, in 1989, barred future VA deficiency claims on loans closed after December 18, 1989 (even when permitted by state law), 38 U.S.C. 3703(e)(1), the residuum of these claims will be painfully felt for many years to come by veterans whose disability and retirement benefits are taken without a hearing, whose tax refunds intercepted, and who suffer other direct collections. The VA exercises administrative set-offs of benefits and entitlements without regard to federal or state statutes of limitation.

The issue of importance to the states is one of federalism: the primacy of maintaining and enforcing laws affecting real property which are legislatively balanced to insure the orderly transfer of title and protect debtors and creditors alike. We believe the District Court reached a proper accommodation of these interests by applying this Court's test set forth in *Kimbell Foods* by holding the law that applies to the relationship between the VA and the lender (guarantor) would be federal (and controlled by 38 C.F.R. 36.4320, and *Shimer*), and the law

between the VA and the borrower (indemnitor) would be controlled by following the foreclosure laws of Idaho. In this way, lenders would not be discouraged from participation in the loan program because of variations in state law, the concern which prompted, in part, this Court's holding in *Shimer*. Conversely, veteran debtors would be treated no harsher than other defaulting home owners under state law and the minimal losses to the VA[2] would be properly treated as an administrative expense which this court has repeatedly held does not justify preemption of state law. *United States v. Kimbell Foods*, 440 U.S. 715, 99 S.Ct. 1448, 59

---

[2] The VA only collects about 3% of deficiency debt. Indeed, most studies find little benefit to creditors with the ability to obtain deficiencies and note that the most significant impact on creditor losses is the length of time it takes creditors to recover the property. That is why the VA has smaller losses in states like California where the property can be recovered after a 90-day non-judicial foreclosure. *See, generally, Schill, "An Economic Analysis of Mortgagor Protection Laws"*, 77 Va. Law Rev. 489 (1991); Meador, *"The Effects of Mortgage Laws on Home Mortgage Rates*, 34 J. Econ. & Bus. 143 (1982); Dietrich, *The Montana Judicial and Non-Judicial Foreclosure Sale*, 49 Mont. L. Rev. 285 (1988); Platt, *Deficiency Judgments in Oregon: Growing Disparities Among Functional Equivalents*, 23 Willamette L. Rev. 37 (1987); and Clauretie, *"State Foreclosure Laws, Risk Shifting, and The Private Insurance Industry"*, 56 J. Risk & Ins. 544 (1989).

L. E.d. 2d 711, (1979); *United States v. Yazell*, 382 U.S. 341, 86 S. Ct. 500, 15 L.Ed.2d 404 (1965).

As the dissent in *Carter* indicates, the VA, having elected to disregard the requirements of Idaho law, should now be bound by the legislative trade-off in the state in which the property is located even if as a result of that trade-off, lenders are limited or barred from collecting deficiencies. Because the VA could have directed the lender to fully protect its interests, an absolute bar to collection of a deficiency in connection with foreclosure of a trust deed is not inconsistent with, and therefore not preempted by, 38 C.F.R. § 36.4323(e).

It is not disputed that federal law governs questions involving the rights of the United States arising under nationwide federal loan programs. *United States v. Kimbell Foods, Inc., supra*. There is, however, a presumption that state law be adopted as the Federal common law, a presumption that is particularly strong in areas traditionally regulated by states, such as property law. *Kamen v. Kemper Financial Service, Inc.,*

supra; *Wilson v. Omaha Indian Tribe*, 442 U.S. 653 (1979); see, also, 28 U.S.C. 1652 (1988). This court has also noted that ". . . a finding of federal preemptions is . . . not favored in the absence of persuasive reasons--either that the nature of the related subject matter permits no other conclusion, or that Congress has unmistakably so ordained." *Florida Lime & Avocado Growers v. Parel*, 373 U.S. 132, 83 S. Ct. 1210, 10 L.Ed.2d 248 (1963)). Moreover, "the presumption operates in favor of the validity of the state law, [and therefore] courts are not to seek out conflicts between state and federal regulation where none exist." *Dupnik v. United States*, 848 F.2d at 1476 (9th Cir. 1988); *see also, United States v. Yazell*, 382 U.S. 341, 86 S. Ct. 500, 15 L.Ed.2d 404 (1965). C.F. *United States v. Little Lake Misere Land Co.*, 412 U.S. 580, 604 (1972), where both Justices Stewart and Rehnquist rejected the appropriateness of an invocation of federal common law, preferring instead to reject the statute as an unconstitutional retroactive impairment of contractual obligations,

or as discriminatory against the federal government. Both Justices argued that federal common law should not apply.

> It seems to me, as a matter of law, not a matter of "choice" or "borrowing", that when anyone, including the Federal Government, goes into the State and acquires real property, the nature and extent of the rights created are to be determined, in the absence of a specifically applicable statute, by the law of the State.

Id. at 605 (Stewart, J., concurring).

> [T]he interest of the Federal Government in having real property acquisitions that it makes in the States pursuant to a particular federal program governed by a similarly uniform rule is too tenuous to invoke the *Clearfield Trust* principle, especially in light of the consistent statements by this Court that state law governs real property transaction.

Id. at 607 (Rehnquist, J., concurring).

The VA's rights as guarantor upon a veteran's default are governed by 38 U.S.C. § 3732. That statute gives the VA the right to subrogation.[3] There is no statutory right to indemnity.

---

[3]38 U.S.C. §3732 provides:

> "[T]he administrator may . . . pay to [the lender] the guarantee not in excess of the pro rata portion of the amount originally guaranteed. If the

The VA claims a right to indemnity based on 38 C.F.R. § 36.4323(e):

> Any amounts paid by the Administrator on account of the liabilities of any veteran guaranteed or insured under the provisions of 38 U.S.C. Chapter 37 shall constitute a debt owing to the United States by such veteran.

The issue in this case is whether that regulation preempts Idaho law which provides that within three months of the foreclosure sale, a lender may seek a money judgment for the balance due on the debt. Idaho Statute §45-1512.

The District Court in this case properly held that 38 C.F.R. § 36.4323(e) should be interpreted to accommodate Idaho law as to the liability of the veterans to the VA, because the VA could fully protect itself[4]. The *Whitehead* court similarly distinguished *Shimer* and held that 38 C.F.R. § 36.4323(e) did not

---

> administrator makes such a payment, the administrator shall be subrogated to the right of the holder of the obligation to the extent of the amount paid on the guarantee."

[4]The District Court noted that "nothing in the record suggests that the VA was unable to comply with Idaho Code had it chosen to do so". 758 F. Supp. at 608.

preempt Washington law which allowed the VA to direct the lender to foreclose judicially and preserve a right to a deficiency, or to foreclose non-judicially and forego the right to a deficiency. The rationale of the *Whitehead* decision was that there was no conflict between federal and state law where the VA could direct the lender to proceed under state law in such a manner as to preserve the right to a deficiency. The same can be done in the Idaho foreclosure scheme. In fact, the Idaho procedure is less burdensome to creditors than the Washington judicial statute[5].

Affirming the District Court is also entirely consistent with recent Congressional legislation aimed at holding good faith

---

[5]In *United States v. Brosnan*, 363 U.S. 237 (1960), the court held that when the federal government elects to use state procedural statues, their lien rights can be defeated "because [these] liens intrude upon the relationships traditionally governed by state law". *Id.* at 240. *Accord United States v. Warford*, 791 F.2d 1519 (11th Cir. 1986). In *United States v. Tacoma Gravel*, 376 F.2d 343, 344 (9th Cir. 1967), the court held that by electing a stated remedy, the United States "voluntarily put itself into the state forum in order to have the benefit of a state judgment [and] was on no better footing than any other litigant availing itself of the state judicial process."

veterans unaccountable for deficiencies resulting from non-judicial foreclosures:

> Moreover, the *Whitehead* opinion is entirely consistent with recent Congressional legislation aimed at holding good faith veterans unaccountable for deficiencies resulting from non-judicial foreclosures. The Act [38 U.S.C. 3703(e)] states with respect to VA loans closed after December 31, 1989, that veterans shall not be liable for any deficiency unless there is "fraud, misrepresentation or bad faith."

Carter v. Derwinski, supra, 758 F. Supp. at 606.

A state's interest in its foreclosure law should not be displaced by an ambiguous regulation with (i) no nexus in statutory language[6], (ii) no relationship to any congressional intent expressed in contemporaneous committee reports or floor debates, (iii) no meaningful "detail," (iv) no direct or indirect expression of intent to preempt, and (v) no meaningful impact on proper functioning of the VA Home Loan Guaranty Program.

---

[6]Indeed, the applicable statute only gives the VA a subrogation right, 38 U.S.C. 3732(a)(1); it is the regulation that expands this right to indemnity. See 38 C.F.R. 36.4323(e).

1. The District Court Correctly Applied the *Kimbell Foods* Test as Set Forth in the *Whitehead* Decision

As the *Carter* panel noted, *Whitehead* would require an affirmance of the District Court. 987 F.2d at 613.

In *Whitehead v. Derwinski*, *supra*, the Ninth Circuit thoroughly reviewed the VA's indemnity rights in the context of Washington foreclosures where state law allowed lenders to elect either a non-judicial procedure, RCW 61.24 et seq, that satisfied the debt in full, see RCW 61.24.100, or a judicial foreclosure procedure, RCW 61.12, where a deficiency could be obtained with additional protections in place to allow redemption. 904 F.2d at 1369. The *Whitehead* court found that adopting state law, while perhaps increasing administrative costs, would not conflict with the objectives of the VA loan program.

In this case, the Ninth Circuit overruled its recent *Whitehead* decision while holding that this court's test in *Kimbell Foods* was "not relevant" to whether the government needed to follow any state laws that impeded the VA's indemnity rights or

otherwise conferred rights in favor of veteran homeowners[7]. The veterans maintain that *Whitehead* was properly decided and the analysis, using *Kimbell Foods*, should control this case as holding the District Court.

The *Whitehead* court noted the shift in preemption analysis following the Supreme Court's decision in *Kimbell Foods* as a reason for its application of Washington law as the federal rule of decision. In *United States v. Shimer* (the principal authority advanced by the VA and followed by the *Carter* panel), this Court

---

[7]It is curious that in cases where litigants try to *enforce* VA regulations, the VA argues that state law provides adequate remedies and federal regulations for debtor relief should not be enforced by courts. The Ninth Circuit has adopted this concept in *Rank v. Nimmo*, 677 F.2d 692, 697 (9th Cir.), *cert denied* 459 U.S. 907 (1982) and concluded, contrary to *Shimer*:

> [I]t [is] most improbable that the VA Act was intended to authorize the federal courts to create, with respect to the area of VA-guaranteed home loans, a federal common law of mortgages to supplement or supplant the law provided by the states. *Id.*

The only possible reconciliation of *Rank* with *Shimer* is a rationale that Congress intends to confer upon the VA all rights and to strip the debtors of all remedies.

held that encouraging lenders to make VA-guaranteed home loans and collection of loans were the two principle purposes of the VA Home Loan Guaranty Program. The court's assumption that collection of defaulted loans was a purpose of the Federal Act was without basis in the Act's legislative history. That aspect of the *Shimer* opinion can now be questioned because of *Kimbell Foods* and many other precedents which hold that recovery of debt is not a goal of most federal lending programs and because of recent Congressional amendments to the VA program. *United States v. Kimbell Foods, Inc.*, 440 U.S. at 733-38.[8] The *Whitehead* court was mindful of this and other Ninth Circuit developments governing state debtor protections and collection of federal debt since *Shimer*, and expressly cited those developments as a separate

---

[8]*See also United States v. Haddon Haciendas Co.*, 541 F.2d 777, 784, n. 8 (9th Cir. 1976) ("Bald assertions of a public fisc interest have not met with favor"); 38 U.S.C. 3703(e) where Congress has banned seeking deficiencies on loans closed after 1989.

basis for applying state law in Part "C" of its Opinion. *Whitehead v. Derwinski*, 904 F.2d at 1369-72; *see* footnote 2, *supra*.[9]

The *Shimer* court held that 38 C.F.R. § 36.4320 displaced *inconsistent* state law as to what the VA would pay the lender in the guaranty because of the extent and detail of the federal regulation as to what the VA would pay the lender on the guaranty, from which it inferred an intent to preempt. Contra, *Hillsborough County v. Automated Medical Labs*, 471 U.S. 707, 714-16, 85 L.Ed.2d 714, 105 S. Ct. 2371 (1985). After reviewing in detail the regulations and the specific, substantive statutory provisions they were intended to implement, 367 U.S. at 377-78, the court concluded that, while "intended to remedy the same

---

[9]More recent preemption cases decided by this court further support the veterans in this case. "Consideration of issues arising under the supremacy clause start[s] with the assumption that the historic police powers of the state [are] not to be superseded by . . . Federal Act unless that [is] the clear and manifest purpose of Congress." *Cepollone v. Liggett Group, Inc.*, 112 S. Ct. 2608, 2617 (1992); *see also Kamen v. Kemper Financial Services*, 111 S. Ct. 1711, 1718, n. 5 (1991) ("the presumption that state law should be incorporated into federal common law is particularly strong in areas in which private parties have entered legal relationships with the expectation that their rights and obligations would be governed by state law standards.")

abuses" as the Pennsylvania law, they were inconsistent with that law. It then held:

> We have no doubt that this regulatory scheme, complete as it is in every detail, was intended to provide the whole and exclusive protection of the interests of the [VA] as a guarantor and was, to this extent, meant to displace inconsistent state law. (Emphasis added).

367 U.S. at 381.

This holding in *Shimer* is not questioned, and the veterans agree with *Shimer's* general proposition that an agency's interpretation of a statute will not be disturbed unless it appears inconsistent with the purpose of the act. *See United States v. Shimer*, 367 U.S. at 383. This is the proposition for which *Shimer* is cited in *Fidelity Federal Savings & Loan v. De La Cuesta*, 458 U.S. 141, 154 (1982), the case which is referred to in *Connelly v. Derwinski*, 921 F.2d 129 (9th Cir. 1992) n 1, as evidence by the *Carter* panel of the continued vitality of *Shimer*.[10] The veterans disagree, however, that *Shimer* stands

---

[10]This is even more true because of the reliance of the Shimer court on 38 C.F.R. § 36.4320 which has now been changed to

today for the proposition that either Washington or Idaho state law, both of which provide a means for foreclosure which allows

---

expressly provide that state law minimum bid calculations can be applied. Moreover, *Shimer* has been cited by this Court in three recent cases: *Hillsborough County v. Automated Medical Laboratories*, 471 U.S. 707, 713 (1985); *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 699 (1984); and *Fidelity Federal Savings & Loan v. De la Cuesta*, 458 U.S. 141, 154 (1982). In each of those cases, however, the court resolved the question of the preemptive effect of a regulation not on inference, as in *Shimer*, but on the explicitly stated intent of the promulgating agency.

Further doubt is case on the current utility of *Shimer's* preemption analysis by the language of a unanimous Court in *Hillsborough*, *supra*, at 713:

> We are even more reluctant to infer preemption from the comprehensiveness of regulations that from the comprehensiveness of statutes. As a result of their specialized functions, agencies normally deal with problems in far more detail than does Congress. To infer preemption whenever an agency deals with a problem comprehensively is critically tantamount to saying that whatever a federal agency decides to step into a field, its regulations will be exclusive. Such a rule, of court, would be inconsistent with the federal-state balance embodied in our Supremacy Clause jurisprudence.

for recovery of a deficiency, are necessarily preempted by 38 C.F.R. § 36.4323(e). As the *Kimbell Foods* court noted, the purpose of the federal lending programs is to assist the intended beneficiaries of the lending program. Application of state debtor protection laws is consistent with that goal[11].

The impact of *Shimer* was thoroughly and thoughtfully considered by the *Whitehead* court. *Whitehead* properly distinguished *Shimer* based on the lack of conflict between state law allowing recovery of a deficiency and 38 C.F.R. § 36.4323(e) requiring the veteran to indemnify the VA for amounts paid on its guaranty and on the long line of subsequent cases decided by both the Supreme Court and other circuits[12]. *Kimbell Foods* limited

---

[11]Conflict preemption arises where it is impossible to comply with both the state and federal law, or where state law stands as an obstacle to the purpose and objectives of the Federal Act. *See English v. General Electric Co.*, 110 S. Ct. 2270 (1990) and *Wisconsin Public Intervenor v. Mortier*, 111 S. Ct. 2476 (1991). See, generally, Alexander.

[12]*See United States v. MacKenzie*, 510 F.2d 39 (9th Cir. 1975) (en banc) (applying state law to limit the SBA's right to a deficiency judgment). *Great S.W. Life Ins. Co. v. Frazier*, 860

the second prong of the *Shimer* holding to the extent that recovery of debt is not a purpose of federal lending programs. The *Whitehead* court, and the District Court in this case, made a reasoned analysis of the way the Supreme Court would decide *Shimer* today. The *Whitehead* court specifically noted the evolution of preemption analysis:

> These cases evidence this court's increased willingness to recognize the application of state law in the context of federal programs. The shift in our analysis has been prompted, to some degree, by the Supreme Court's decision in

---

F.2d 896, 900 (9th Cir. 1988) (adopting Idaho rule on impairment of collateral to limit SBA's recovery on a loan); *Dupnik v. United States*, 848 F.2d 1476, 1481-85 (9th Cir. 1988) (applying state procedural law to forfeit the SBA's right to redeem property); *United States v. Pastos*, 781 F.2d 747, 750, 751-52 (9th Cir. 1986) (upholding a right of redemption although the mortgage held by the SBA included a provision that "expressly waived all redemption rights"); *United States v. Ellis*, 714 F.2d 953, 954 (9th Cir. 1979) (Washington law) (upholding a right of redemption although the "mortgage held by the FmHA include[ed] a provision expressly waiving any rights to redemption"); *United States v. Crain*, 589 F.2d 996, 1000 (9th Cir. 1979) (applying Arizona law relieving a guarantor where the creditor--in this case, the SBA--failed to protect the property of the principal). The *Carter* decision foreshadows reversal of this line of cases which will have incalculable effects on the business community in the Ninth Circuit.

> *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 728-29, 99 S. Ct. 1448, 1458-59, 59 L.Ed.2d 711 (1979).

Whitehead v. Derwinski, 904 F.2d at 1370-71.

The *Whitehead* court correctly concluded that state law allowing recovery of a deficiency did not conflict with a federal right to indemnity and that current Supreme Court and other Circuit court preemption analysis supported application of Washington foreclosure law in the context of collecting VA home loans[13]. It ended with the right decision. The VA has offered

---

[13]Squarely in point but of lesser impact on the VA is *Sitton v. United States*, 413 F.2d 1386 (5th Cir. 1969) *cert denied* 397 U.S. 988 (1970). In *Sitton*, the VA sought to collect on a deficiency claim arising after it paid on the guaranty. Texas law provided that there could be no deficiency against a married woman even though she had agreed, with her veteran husband, to be liable to the VA. The Court rejected the VA's claims that *United States v. Shimer*, *infra*, and *McNight v. United States*, 259 F.2d 540 (9th Cir. 1958) (relied upon by the Ninth Circuit, 987 F.2d at 616) gave the VA an independent right of indemnity and followed *United States v. Yazell*, 382 U.S. 341 (1965) which, although dealing with a claim by the Small Business Administration for a deficiency, adopted state law. In *Sitton*, the court held:

> The Veterans Loan Guaranty program will not suffer major damage if the Texas law of coverture is applied in this

no valid reason for modifying or overruling *Whitehead*, other than an apparent, but unnecessary, conflict with *Shimer*. Indeed, the argument that *Whitehead* should be overruled appears to have been based on a mistaken understanding that VA regulations did not accommodate state law. 38 C.F.R. 36.4320(f).

The *Whitehead* court refused to construe 38 C.F.R. § 36.4323(e) to preempt Washington law because the regulations regarding foreclosure are not "complete in every detail," but rather looked to state law for specificity and substance:

> case. Since we find that under the law of Texas, where the contract was made, Mrs. Sitton was protected by the doctrine of coverture from personal liability upon the contract, the judgment of the District Court with respect to her must be reversed.
>
> We also note that there is no clear statutory authority for overriding the Texas domestic relations law in this case, nor do we have regulations promulgated pursuant to a statute which require us to invade the "strong state interest involved here".

> Unlike the regulation in *Shimer*, the regulations at issue here do not provide a scheme for foreclosure "complete in every detail." While the regulations provide for an independent right of indemnity, they do not establish specific foreclosure procedures. In contrast to the tightly woven regulation addressed in *Shimer*, the regulations addressing foreclosure procedures are a loose framework that takes its substance and specificity from applicable state or local laws. *See, e.g.*, 38 C.F.R. §§ 36.4315(b)(2), 36.4319, 36.4320, 36.4323(c). They therefore do not indicate an intent to displace applicable state law, as did the regulations in *Shimer*.

Whitehead, supra at 1368.

This court in *Shimer* was primarily influenced by the potential impact of state law on the guaranty calculation which established the amount the VA paid to lenders. The Court was concerned that subjecting lenders to the vagaries of state law as a precondition to collecting on guarantees would result in the lenders declining to participate in the VA Home Loan Guaranty Program. 367 U.S. at 384. This, of course, would have clearly impacted the home loan program's objectives.

The same cannot be said about 38 C.F.R. § 36.4323(e). That regulation affects only the veteran's debt to the VA and does

not affect lenders nor have a measurable impact on the overall home loan program. Clearly, lenders in Idaho would not refuse to participate in the VA Home Loan Guaranty Program if the VA (like other Idaho guarantors) was required to follow state law to establish a deficiency debt.

The fact that 38 C.F.R. § 36.4323(e) relates to the veteran's obligation to the VA and not to the VA's obligation to the lender was deemed significant by the District Court which further distinguished *Shimer*:

> In *Shimer*, the United States sued a veteran to recover the amount the VA had paid to the lender upon the veteran's default. However, to the extent the Supreme Court discussed conflicts between state law and federal regulations, the crux of the decision in *Shimer* was that federal law should control the amount of money which the VA should pay lenders. *United States v. Shimer*, 367 U.S. at 377-81. The reasoning in *Shimer* is not inconsistent with the finding that deficiencies owing from veterans must be determined under state laws, such as those in Washington and Idaho. Therefore, *Shimer* does not, and should not, defeat the claims of the plaintiffs in the case at bar.

Carter v. Derwinski, 758 F. Supp. 607.[14]

The District Court's interpretation of 38 C.F.R. §36.4323(e) avoids a conflict between the VA and the class members by reaching a reasonable accommodation of the interests involved and should be affirmed. The regulation is silent regarding the effect of state foreclosure laws and how an indemnity right might be enforced. It does not state that the VA has an absolute right to indemnity regardless of state foreclosure laws. Even though this is the interpretation placed on it by the VA, that interpretation is not controlling if it is plainly erroneous or inconsistent with the statute. *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414, 65 S. Ct. 1215, 1217, 89 L.Ed. 1700 (1945). The veterans contend that the VA's interpretation is both plainly erroneous and inconsistent with the statute and other

---

[14] An increasing number of District Courts have rejected *Shimer* in the face of VA deficiency claims and have allowed state law defenses. *See, e.g., United States v. Vallejo*, 660 F. Supp. 535 (W.D. Wash. 1987); *United States v. Whitney*, 602 F. Supp. 722 (W.D.N.Y. 1985); *United States v. Murdoch*, 627 F. Supp. 272 (N.D. Ind. 1986); *United States v. Church*, 837 F. Supp. 1494 (N.D. Ind. 1989).

regulations which clearly contemplate foreclosure under all aspects of state law. *See*, 38 U.S.C. § 3720(a)(6); § 38 C.F.R. § 36.4319 and § 36.4320.

The VA regulations are replete with references to state law and indicate considerable dependence upon state law[15].

---

[15]For example, 38 C.F.R. § 36.4315(b)(2)(vii) provides for return of a mortgagor's partial payment if "foreclosure has been commenced by the taking of the first action required for *foreclosure under local law.*" 38 C.F.R. § 36.4320(d) specifies the procedure for sale of security where "a minimum bid is *required under applicable state law.*" After the VA pays on its guarantee, 38 C.F.R. § 36.4323(c) requires it to file the instrument reflecting that payment "in the office of the recorder of deeds, or other appropriate office of the proper county . . . , *in accordance with the applicable state law.*" It further provides: "The filing or failure to file such instrument for records *shall have the legal result prescribed by the applicable law of the state where the real or personal property is situated*, with respect to filing or failure to file mortgages or other lien instruments and assignments thereof." The VA's Policy Manual, p. 1-59, 4.c(2)(b), clearly contemplates that state deficiency laws may require a full bid. In addition, the only instance in which the holder's right to convey the property to the VA is not lost if an excessive bid is made, is when the excessive bid was made *because required by local law.*" (emphasis added)

38 U.S.C. § 3732(c)(7) governs minimum bids required under state foreclosure laws and accommodates state minimum bids. 38 C.F.R. § 36.4319(d) contemplates the VA (if named a party) to be represented by "an authorized attorney" within the time "required by applicable law, or rule of court." 38 C.F.R. §

The regulation at issue in this case, 38 C.F.R. § 36.4323(e), provides that amounts paid on account of the liabilities of any veteran shall constitute a debt owed by the veteran to the VA. It is silent and therefore ambiguous as to (1) how the "liability" is established, and (2) the effect of 38 U.S.C. § 3720(a)(6) and other VA regulations specifying that foreclosure is to be in accordance with the law of the state in which the property is situated.

Ambiguous portions of statutes or regulations must be construed to give effect to the entire body of statutes and regulations consistent with their purpose. *Clark v. Portland General Elec. Co.*, 111 F.2d 703 (9th Cir. 1940). The District

---

36.4320(a)(3)(ii) and § 36.4320(d)(4) both relate to the possibility of a minimum bid "required under the applicable state law." 38 C.F.R. § 36.4320(h)(5) demands that a proper conveyance to the VA (i.e., deed in lieu of foreclosure) shall entitle the secretary to "such title as is or would be acceptable to prudent lending institutions, informed buyers, title companies, and attorneys generally *in the community in which the property is situated.*" 38 C.F.R. § 36.4320(j) allows VA officials to authorize a deviation from the provision of the section, "if such deviation is made necessary by reason of any laws or practice in any State or Territory or District of Columbia."

Court properly construed 38 C.F.R. § 36.4323(e) to be consistent with the purpose of the VA Home Loan Guaranty Program. *Cf.*, *F.T.C. v. Fred Meyer, Inc.*, 390 U.S. 341, 88 S. Ct. 904, 19 L. Ed. 1222 (1968).

In order to give effect to 38 U.S.C. § 3720(a)(6) and the VA regulations specifying that foreclosures are to be conducted in accordance with state law, it is proper to construe 38 C.F.R. § 36.4323(e) to obligate the veteran to indemnify the VA only where applicable state foreclosure law affords that remedy. Otherwise the requirement that foreclosures be conducted in accordance with state law is meaningless (and deceptive). Requiring compliance with state law is absurd unless lack of compliance also meets with the consequences afforded by that law and the government complies with the provisions of state law. Congress is certainly free to enact a federal foreclosure statute or otherwise expressly preempt features of state foreclosure laws deemed inimical to the VA program.

The District Court's construction is consistent with the purpose and broad policy of the VA Home Loan Guaranty Program. The stated purpose of the Serviceman's Readjustment Act of 1944, 58 Stat. 291, as amended by 59 Stat. 626, now 38 U.S.C. § 1801 *et seq.*, is to benefit veterans by making it easier for them to buy homes[16]. The VA Home Loan Guaranty Program is similar to the SBA, FmHA, FHA and other government loan programs. Each is a form of social welfare legislation. The primary purpose of such programs is to benefit those to whom the legislation is directed:

> They [the SBA and FHA lending programs] are a form of social welfare legislation, primarily designed to assist farmers and businesses that cannot obtain funds from private lenders on reasonable terms. We believe that had Congress intended the private commercial sector, rather than taxpayers in general, to bear the risks of default entailed by these public welfare programs, it would have established a priority scheme

---

[16]Although the Ninth Circuit began its opinion by noting VA loans are more favorable than conventional loans, 987 F.2d at 612, they are in fact competitive and not significantly preferable to most other loans. A "no down payment" loan has a commensurate increase in the payment and the veteran is, of course, obligated to repay the full amount of the loan.

> displacing state law. Far from doing so, both Congress and the agencies have expressly recognized the priority of certain private liens over agencies' security interests, thereby indicating that the extraordinary safeguards applied in the tax lien area are unnecessary to maintain the lending program.

United States v. Kimbell Foods, Inc., supra, 440 U.S. at 735.

Giving full effect to state anti-deficiency laws is consistent with the purpose of the VA Home Loan Guaranty Program to benefit veterans. *See, United States v. Ellis*, 714 F.2d 953, 956-57 (1983). *See also, United States v. Pastos*, 781 F.2d 747 (9th Cir. 1986), where the court stated:

> In fact, extending redemption right protection is consistent with the SBA's goal of assisting small business. To deprive those very businessmen of protection from economic overreaching [during foreclosure sales] will adversely affect their ability to survive a foreclosure and to start afresh and will potentially deter those whom Congress . . . [intended to benefit].

Id. at 751.

The question is then whether state law is "an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *United States v. Whitney*, 602 F. Supp.

722, 728 (W.D.N.Y. 1985), *citing Fidelity Federal Savings and Loan Association v. de la Cuesto*, 458 U.S. 141, 153, 102 S. Ct. 3014, 3022, 73 L.Ed.2d 664 (1982)[17]. As noted above, giving effect to state foreclosure laws is consistent with, not an obstacle to, accomplishing the purposes of the VA Home Loan Guaranty Program. For example, in *United States v. Vallejo*, 660 F. Supp. 535, 539 (W.D. Wash. 1987) (appeal to the Ninth Circuit withdrawn by the VA), the court found that allowing the VA to circumvent the debtor protections under Washington law would "in addition to increasing the risk of loss a veteran faces, the

---

[17]In *Whitney*, a ruling which the VA has adopted in DVB Circular No. 26-87-465, the court held, 602 F. Supp. at 735:

> The Government would seek to hold the veteran personally obligated for any deficiency that remained after the foreclosure sale, even though he was denied the notice required by state law and was therefore precluded from presenting any defense he could have interposed, including the exercise of his equity of redemption. This Court cannot conclude that Congress intended to strip the veterans of such fundamental elements for due process of law, particularly under the provisions of a federal program designed for their benefit.

government's position would deter veterans from seeking VA-guaranteed loans, a result Congress could not have intended."

2. **Idaho Law Has Been Properly Adopted by the District Court as the Federal Rule of Decision for Idaho**

The *Kimbell Foods* decision required the District Court to consider (1) whether a nationally uniform body of law is necessary; (2) whether application of state law would frustrate specific objectives of the federal program; and (3) whether application of the federal rule would disrupt commercial relationships predicated on state law.

In considering these three factors, the District Court followed *Whitehead* which held that (1) a nationally uniform body of law relating to foreclosure of VA-guaranteed home loans was neither necessary (nor even possible) because the federal regulations themselves contemplate foreclosure in accordance with applicable state law; (*supra* at 1371); (2) application of state law would not frustrate specific objectives of the federal program contrary to the VA's argument that increased costs should prevent

adoption of state law;[18] and (3) allowing the VA to ignore state foreclosure law would disrupt commercial relations predicated on state law:

> In adopting the dual foreclosure scheme, the Washington legislature balanced the debtors' and lenders' rights. (citation omitted)
>
> Non-judicial foreclosure obviously provides significant advantages to a creditor seeking to liquidate security for a defaulted loan; these advantages have been conferred by the legislature in return for the creditors' relinquishment of the right to obtain a deficiency judgment.' (citation omitted) Allowing the VA to instruct lenders to foreclose non-judicially under Washington law, and then use its federal right to indemnity to override the consequences of that instruction, circumvents the balance the state legislature intended in designing and adopting the two foreclosure options.

Supra at 1372.

---

[18]*See also, North Dakota v. United States, supra,* (fact that state statute increased burdens or costs on federal government procurement will not support preemption of state laws). *United States v. Yazell*, 382 U.S. 341 (1966); *United States v. Vallejo*, 660 F. Supp. 535 (W.D. Wash. 1987).

To allow the VA to circumvent the consequences of having ignored important features of Idaho law would circumvent the balance the Idaho legislature intended and squarely violate this court's holding in *Kimbell Foods*.

The VA now has persuaded the Ninth Circuit that *Whitehead* was decided wrongly because the *Whitehead* court failed to perceive the real "conflict" between the state law and the federal regulation. At the first hearing of this appeal in the Ninth Circuit on June 4, 1992, the VA argued that the conflict between the state and federal law arises because the fair market value under both the Idaho and Washington fair value/upset price provisions may be determined to be higher under state than under federal law, which would reduce the deficiency, i.e., the amount of dollars subject to collection, thus impairing the federal interest in collection.[19]

The VA's argument ignored significant changes to 38 C.F.R. § 36.4320, promulgated since the *Shimer* decision, as well

---

[19]The government subsequently withdrew this argument as "in error" when argued before the *en banc* panel.

as the evolution of preemption analysis beginning with *United States v. Kimbell Foods*, which was given as a reason for distinguishing *Shimer* by the *Whitehead* court. *Whitehead* at 1367-68 and 1369-71. The veterans urge this court to affirm *Whitehead*, and its application to this case and to distinguish *Shimer* based on the changes in 38 C.F.R. §36.4320 since 1960, and further based upon the development of case law since *Kimbell Foods* used by the court as an alternative bases for affirming the *Whitehead* decision.

The *Shimer* court found that 38 C.F.R. § 36.4320 conflicted with Pennsylvania law requiring a post-sale, fair value determination to mitigate any deficiency claim because it was impossible to comply with both the state law and 38 C.F.R. § 36.4320 which provided different methods for calculating the amount to be credited against the veteran's indebtedness.[20] At

---

[20]The Third Circuit in *Shimer*, 276 F.2d at 792, had also held that the lender's guaranty claim was defeated because of non-compliance with the Pennsylvania statute. The Supreme Court reversed this finding because lenders would be discouraged from participating in the VA program. We don't question that portion

the time *Shimer* was decided, 38 C.F.R. § 36.4320 specifically provided that state law requirements for a minimum bid would not affect the amount the VA would pay the lender on its guaranty. *See Shimer*, 367 U.S. at 381, n. 8. The regulation then provided, in relevant part:

> If a minimum bid is required under applicable state law, a decree of foreclosure or order of sale, or other lawful order or decree, the holder may bid an amount not exceeding such amount legally required. . . . the amount paid or payable by the Administrator under the guaranty shall not be subject to any adjustment by reason of such bid.

"Minimum bid", "upset price", and "fair value" are different terms for the same concept, i.e., a device to protect the debtor from an unreasonably low determination of fair market value and consequently a large deficiency judgment. Since *Shimer* was decided, 38 C.F.R. § 36.4320 has been amended and now provides that where state law requires a minimum bid, the minimum bid will govern instead of the amount specified by the regulation for purposes of determining the VA liability under the

---

of the court's holding.

loan guaranty. 38 C.F.R. § 46.4320 (1988) now provides (in part):

> (3) If a minimum bid is required under applicable State law, or decree of foreclosure or order of sale, or other lawful order or decree, and; (i) Such minimum bid exceeds an amount which has been specified by the Administrator under paragraph (a)(1) of this section; and (ii) The holder acquires the property at the liquidation sale for an amount not exceeding the amount legally required; the holder may elect to convey the property to the Administrator pursuant to paragraph (a)(1)(ii)(A) of this section. The amount bid at the sale or the total indebtedness, whichever is less, shall govern instead of the specified amount and for the purpose of determining the Administrator's liability under loan guaranty.

The regulation now provides exactly the opposite of the language that formed the basis for the holding in *Shimer*.

It is, therefore, consistent with the regulation for the VA to direct the lender to comply with state foreclosure law which allows the recovery of a deficiency and to recover the lesser amount paid from the veteran on a theory of indemnity. This is true even though the determination of fair market value may be higher under the state than under the federal law because 38

C.F.R. § 36.4320 specifically contemplates such an occurrence and provides that the amount the VA pays on its guaranty shall be adjusted. Because the regulation now takes state fair value determinations or minimum bid requirements into consideration for purposes of determining the VA's liability on its guaranty, the conflict posited by the VA does not, and cannot, exist. 38 C.F.R. § 36.4320(3) expressly provides that state law minimum bid and by logical extension, the functionally equivalent upset price or fair value determinations shall be taken into consideration in determining the amount the VA is to pay on its guaranty.[21]

B. CONFLICT AND CONFUSION IN THE CIRCUIT COURTS AS TO THE APPROPRIATE PRE-EMPTION TEST

The veterans rely principally upon this court's test set forth in *United States v. Kimbell Foods* (as did the District Court), which was properly the law in the Ninth Circuit until this case was

---

[21]The *Shimer* court seemed to recognize the functional equivalence of the various state law devices to establish fair value and used the terms interchangeably. *See Shimer*, 367 U.S. at 380, where the court discusses "minimum credit" and "upset price" interchangeably.

decided by an *en banc* panel of that court[22]. The Ninth Circuit's history with preemption represents a microcosm of the confusions in other courts[23]. Professor Alexander describes generally the area of law:

> In key areas of real estate finance, where the states have developed complex allocations of rights and duties among debtors and creditors, judicial determinations of controlling law have proven neither consistent nor predictable.

Supra, at 323. See also citation in note 168, Id., comparing dozens of cases dealing with preemption. Professor Alexander

---

[22] It is telling that the application of the *Kimbell Foods* test in *Whitehead* garnered three judges' concurrence and the rejection of the *Kimbell Foods* test in this identical case prompted four dissents: an even split of 14 judges in these two cases.

[23] The multitude of different approaches used by lower courts is described as "chaos". Alexander, *Federal Intervention in Real Estate Foreclosure: Preemption and Federal Common Law*, 71 N.C. Law Review 295, 340 ff. (1993). The Ninth Circuit has allowed pre-emption of Idaho law in this case, but disallowed similar preemption claims by other federal agencies. See, *Great SW v. Frazier*, 860 F.2d 896 (9th Cir. 1988).

follows an exhaustive analysis of the cases beginning with *U.S. v. Shimer, supra*:

> One might innocently have thought that this decision would have clarified this issue, and that as a general proposition federal mortgage loan program regulations would preempt state anti-deficiency laws. In the thirty-odd years since *Shimer*, however, this has not been the case.

Supra, at 324.

The author concludes that the courts have had difficulty applying the *Kimbell Foods* test and the same courts have reached diametrically opposed conclusions with respect to the VA home loan program. Id at 327 comparing this case (the District Court opinion) and others with *Jones v. Turnage*, 699 F.Supp 795 (N.D. Cal. 1988), in footnotes 174 and 187[24].

---

[24] In *Nelson & Whitman*, the leading real estate finance law treatise, *supra*, note p. 820, the authors conclude as to the *Kimbell Foods* test: "If the court believed that its new test provided enough specificity to produce consistent results in the lower Federal Courts it was mistaken". The Ninth Circuit has adopted the *Kimbell Foods* test, *Great Southwest v. Frazier*, 860 F.2d 896 (9th Cir. 1988); *Dupnik v. United States*, 848 F.2d 1476 (9th Cir. 1988), although rejecting it in this case by a slim majority), the

Other circuits have applied *Kimbell* in similar situations and adopted state law. In *Chicago Title Ins. Co. v. Sherred Village Assoc.*, supra, 708 F.2d, 804, 810-13 (1st Cir. 1983), the First Circuit meticulously applied the *Kimbell* test in a lien priority case and rebuffed the government's arguments for rejecting state law and fashioning a uniform federal common law rule.

The Fifth Circuit, in *United States v. Irby*, 618 F.2d 352, 335 (5th Cir. 1980) adopted Mississippi law to prevent recovery by the Small Business Administration of a deficiency: "Traditionally, the regulation of the transfer or real property has been a local concern." In *United States v. Dismuke*, 616 F.2d

---

Eighth Circuit rejected *Kimbell Foods, Victory Highway Village, Inc. v. Weaver*, 634, F.2d 1099 (8th Cir. 1978); *Vail v. Derwinski*, ____ F. 2d _____, the Seventh Circuit has rejected *Kimbell Foods* in *Davis v. Derwinski*, 961 F.2d 603 (7th Cir. 1992). The Fifth Circuit has followed *Kimbell Foods*, SKA Assoc. case and Dismuke 616 F.2d 755 (1980). Professor Alexander concludes: "There is no agreement whatsoever on whether the availability of a deficiency judgment, a binding foreclosure without right of redemption, or consistent notice requirements constitute a sufficient justification for imposed national uniformity. *Supra*, at p. 350-356.

755, 759 (5th Cir. 1980), the same court held that a Georgia anti-deficiency statute was to be adopted as the federal rule of decision to bar an SBA deficiency claim. The court concluded:

> Though we are concerned here with a different type of state law provision, it is clear that in this instanced also state law incorporation would in no way hinder the administration of the loan program and that the statute presents no difficulty to the SBA in protecting itself.
>
> This court has already applied the *Kimbell* reasoning to an issue not resolved by that case. We are impressed that the "very detailed opinion for a unanimous Court in *Kimbell* sought to carefully instruct Government agencies that in their commercial lending activities they were subject to 'customary commercial practices' [440] U.S. at [732], 99 S.Ct. at 1461, and should fare no better, and no worse, than a private lender.

Id. at 759.

In *United States v. S.K.A.*, 600 F.2d 513, 516 (5th Cir. 1979), Florida law was adopted to thwart another SBA claim of priority over private creditors. Finally, *Kimbell Foods* supplies the answer to this query:

> ...a national rule is unnecessary to protect the federal interests underlying the loan programs. Accordingly, we adopt state law as the

> appropriate federal rule for establishing the relative priority of these competing federal and private liens.
>
> ...Incorporating state law to determine the rights of the United States or against private creditors would in no way hinder administration for the SBA and FHA loan programs (440 U.S. at 729).

The court noted, as in the case herein, that a "fair reading of the SBA Finance Assistance Manual . . .indicates that the agency assumes its security interests are controlled to a large extent by the commercial law of each state." 440 U.S. at 731. No less can be said about the VA regulations and policies.

IV. CONCLUSION

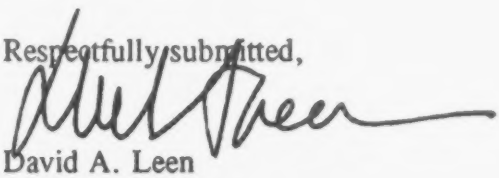
What emerges from a review of these recent preemption cases is that, while "every subject that merits Congressional legislation is, by definition, a subject of national concern[,] [t]hat cannot mean...that every federal statute ousts all related state law." *Hillsborough*, 471 U.S. at 719; *see, Puerto Rico Dept. of Consumer Affairs v. Isla Petroleum Corp.*, ____ U.S. ____, 108 S.Ct. 1350, 1353-54 (1988). The veterans respectfully submit that over the past 33 years, this Court has developed a very different analytical framework for preemption cases than *Shimer* reflects. While *Shimer* may continue to be cited for the general proposition that regulations promulgated under appropriate statutory authority can displace state law, see *Fidelity Federal Sav. & Loan Ass'n*, *supra*, 458 U.S. at 154, the next step under current law would be to determine if the regulations were explicitly "intended to preempt", *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. at 699 (emphasis added). No such explicit statement of intent is to be found in, 38 C.F.R. § 36.4323(e). The regulation relied upon by

the government in this case. And, because the VA must use state law to foreclose, there is substantial evidence that preemption was not intended[25]. In view of this, we submit the decision of the District Court in this case should be affirmed.

For the reasons stated, the petition for a writ of certiorari should be granted.

Dated: May 28, 1993.

Respectfully submitted,



David A. Leen
Counsel of Record
520 E. Denny
Seattle, WA 98122
(206) 325-6022

---

[25]Compare 38 U.C.S. § 3728 which expressly preempts state usury laws. When Congress wants to make its intent clear, it does so.

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WASHINGTON

HAROLD D. WHITEHEAD, CAROLE M. UNDERWOOD, JAMES C. JENSEN, JR., GREGORY M. SMITH, and and PAUL D. BRADY, individually and on behalf of all others in the State of Washington similarly situated,	)))CLASS ACTION))CAUSE NO 89-35069)))
Plaintiffs,	)
vs.	)
EDWARD J. DERWINSKI, Secretary of the Department of Veteran's Affairs,	)))
Defendants.	)

No. 89-35069.
United States Court of Appeals, Ninth Circuit.
Argued and Submitted March 7, 1990.
Decided June 4, 1990.

Mark B. Stern, Dept. of Justice, Civ. Div., Washington, D.C., for defendants-appellants.

David A. Leen, Leen & Moore, Seattle, Wash., for plaintiffs-appellees.

Appeal from the United States District Court for the Western District of Washington.
Before BROWNING, ALARCON and RYMER, Circuit Judges.

RYMER, Circuit Judge:

APPENDIX A

Appellant, the Secretary of the Department of Veteran Affairs ("VA"), appeals from the summary judgment against him in a class action on behalf of veterans[1] in the state of Washington from whom the Department of Veteran Affairs is seeking to collect deficiencies remaining after default and foreclosure on VA-guaranteed home loans. The district court held that the VA's rights, as guarantor, against the debtor could not exceed the lender's rights, and therefore found the VA's claims against the veterans barred by Washington's antideficiency law.

Although we disagree with the district court that the VA has no right to indemnity, the VA may, in the state of Washington, choose whether to instruct a lender to pursue judicial foreclosure, under which the debtor may be held personally liable for the full amount of the debt, or non-judicial foreclosure, in which case no deficiency may be collected. Wash.Rev.Code Ann. ss 61.24.040, 61.24.100 (Supp.1989). The VA has chosen to instruct Washington lenders to pursue nonjudicial foreclosure. Because this method, under Washington law, does not allow the lender to collect a deficiency judgment, the VA cannot proceed against the debtor by way of its statutory right to subrogation. See 38 U.S.C.A. s 1832 (West Supp.1989). However, it could have chosen the other path, exercised its statutory subrogation right,

---

[1]The class is composed of all Veterans or widows of Veterans or other individuals eligible for home loan guarantees or insurance provided pursuant to Title 38, United States Code, Chapter 37, against whom a claim has been or will be made by the United States, pursuant to 38 C.F.R. 36.4323(e) or pursuant to a written indemnity agreement, which claim has been or will be generated because of a claim paid by the United States to a lender who submitted such claim to the United States because of a non-judicial foreclosure conducted in the State of Washington and in accordance with Chapter 61.24 Revised Code of Washington. *Whitehead v. Turnage*, 701 F.Supp. 795, 796 (W.D.Wash.1988).

and collected in full against the debtor. Therefore, Washington law is consistent with federal law in providing the VA a full remedy against the debtor. Accordingly, in this case, Washington state law provides the federal rule for decision, and the VA is bound by the consequences of the path it chooses under that law. We affirm.

I.

The Department of Veteran Affairs provides housing assistance to veterans by guaranteeing home loans made to veterans by private lenders. See generally 38 U.S.C.A. ss 1801-33 (West 1979 & Supp.1989); 38 C.F.R. Part 36 (1989). Federal law governs the guaranty agreement between the veteran and the VA. See VA Form 26-1820; VA Form 26-1802a.
If a veteran defaults on a loan, the lender must give the VA thirty days notice before foreclosing. 38 C.F.R. s 36.4317. The VA then has fifteen days in which to give the lender instructions as to the proceedings[2]. 38 C.F.R. s 36.4324(f). The statute does not establish a federal foreclosure proceeding, but instead contemplates foreclosure under state or local law. See 38 U.S.C.A. ss 1820(a)(6), 1832; 38 C.F.R. ss 36.4319, 36.4320.

The VA must reimburse the lender for certain losses remaining after the foreclosure sale. 38 C.F.R. s 36.4321. The VA may then recover from the borrower the amount the VA paid to the lender [3]. 38 C.F.R. s 36.4323(a), (e) (any amounts paid

---

[2]The VA does not participate in the actual foreclosure proceeding unless the lender is not reasonably diligent. 38 C.F.R. s 36.4319(f).

[3]The Veterans' Benefits Amendments of 1989, Pub.L. No. 101-237, 103 Stat. 2062, amend 38 U.S.C. s 1803 to provide: [A]n individual who pays a fee under section 1829 of this title, or who is exempted under section 1829(c)(1) of this title from paying such fee, with respect to a housing loan guaranteed or insured

by the VA on account of liabilities of the veteran "constitute a debt owing to the United States" by the veteran); VA Form 26-1820; VA Form 26-1802a.

Washington law governed the foreclosures at issue in this action. Washington provides two foreclosure methods. In a non-judicial foreclosure under Wash.Rev.Code Ann. s 61.24.040, the proceeds of the foreclosure sale are deemed to satisfy the debtor's obligation to the lender in full; the lender may not proceed personally against the debtor to collect any deficiency. Wash.Rev.Code Ann. s 61.24.100.

On the other hand, judicial foreclosure under Wash.Rev.Code Ann. s 61.12.040 allows the lender to seek a deficiency, see Wash Rev.Code Ann. s 61.12.070, but also provides the debtor significant rights: (1) the right to a court order providing a minimum price at which the property can be sold in foreclosure, Wash.Rev.Code Ann. s 61.12.060; (2) the right to redeem the property within one year, Wash.Rev.Code Ann. s 6.23.020, and (3) homestead rights, Wash. Const. art. XIX, s 1. See *Donovick v. Seattle-First Nat'l Bank*, 111 Wash.2d 413, 757 P.2d 1378, 1381 (1988) (en banc) (Dore, J., dissenting). Judicial foreclosure is more time-consuming and more expensive. See id. at 1380; see also id. at 1381-82 (Dore, J., dissenting).

---

under this chapter that is closed after December 31, 1989, shall have no liability to the Secretary with respect to the loan for any loss resulting from any default of such individual except in the case of fraud, misrepresentation, or bad faith by such individual in obtaining the loan or in connection with the loan default. Id. at s 304(a), 103 Stat. at 2073. As a result of the new legislation, our decision in this case will only impact veterans whose loans closed prior to December 31, 1989.

The VA instructs Washington lenders to proceed by non-judicial foreclosure. Even though the procedure does not permit the lender to seek a deficiency judgment against the debtor, the VA has attempted to collect the amount of any loss it incurs in reimbursing the lender for deficiencies remaining after foreclosure by asserting a right to indemnity.

The appellee class of veterans brought suit, claiming that under Washington law the non-judicial foreclosure sale satisfies its obligations both to the lender and to the VA. The VA maintains that under federal law it possesses both a right of subrogation, which depends on the debtor's obligation to the lender, and an independent right to indemnity arising from its agreement with the debtor.

On cross-motions for summary judgment, the district court granted summary judgment for plaintiffs.

II.

We review a district court's grant of summary judgment de novo. See *Kruso v. International Tel. & Tel. Corp.*, 872 F.2d 1416, 1421 (9th Cir.1989); *State Farm Fire & Casualty Co. v. Martin*, 872 F.2d 319, 320 (9th Cir.1989).

III.

A. Federal law governs questions involving the rights of the United States arising under nationwide federal programs. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 726, 99 S.Ct. 1448, 1457, 59 L.Ed.2d 711 (1979). The VA's rights, as guarantor, upon default by a debtor are governed by 38 U.S.C.A. s 1832. The statute provides for a right to subrogation. [T]he Administrator may ... pay to [the lender] the guaranty not in excess of the pro rata portion of the amount originally guaranteed. If the Administrator makes such a payment, the Administrator shall be subrogated to the rights of the holder of the obligation to the extent of the amount paid on the guaranty. Id. at s 1832(a)(1).

The regulations interpreting the statutory provisions include a section headed "Subrogation and indemnity." 38 C.F.R. s 36.4323. The section first discusses subrogation. The Secretary shall be subrogated to the contract and the lien or other rights of the holder to the extent of any sum paid on a guaranty or on account of an insured loss, which right shall be junior to the holder's rights as against the debtor or the encumbered property until the holder shall have received the full amount payable under the contract with the debtor. 38 C.F.R. s 36.4323(a). The VA's right to subrogation is dependent on the lender's right, so that in a Washington non-judicial foreclosure, where the lender has no right to collect a deficiency, the VA has none either.

The VA's primary claim in this case is that it has a right to indemnity from the debtor independent of its right to seek subrogation on the basis of the lender's claim. The district court held, "The government's right to indemnification goes no farther than the borrower's obligation to the lender." *Whitehead v. Turnage*, 701 F.Supp. 795, 796 (W.D.Wash.1988) (citing *United States v. Vallejo*, 660 F.Supp. 535, 539-40 (W.D.Wash.1987)). 38 C.F.R. s 36.4323(e) provides: "Any amounts paid by the Secretary on account of the liabilities of any veteran guaranteed or insured under the provisions of 38 U.S.C. Chapter 37 shall constitute a debt owing to the United States by such veteran." See also VA Form 26-1820; VA Form 26-1802a. In 1945, the Administrator of the Veterans' Administration, interpreting the forerunner of the current regulation[4], stated that, as guarantor, the

---

[4]Compare 38 C.F.R. s 36.4323(a), (e) (1989), with former regulations 38 C.F.R. ss 4043(a), 4044, cited in Decisions of the Administrator of the Veterans' Administration, No. 625 at 1154, 1157 (Jan. 22, 1945). The original regulations stated "a debt due" instead of "a debt owing." In addition, the original regulations state that no creditor release will impair the VA's rights, "by virtue of the lien, or otherwise." 38 C.F.R. s 4043(a). The regulations now provide that no release will impair the VA's rights "with respect to the debtor's obligation." 38 C.F.R. s 36.4323(a) (1989).

VA "is entitled to recover indemnification from the principal debtor. This is true, notwithstanding that the creditor could not at the time the guarantor sues the principal debtor maintain a suit against the latter." See Decisions of the Administrator of the Veterans' Administration, No. 625 at 1154, 1157 (Jan. 22, 1945). The Administrator's interpretation of the statute is controlling unless "plainly erroneous or inconsistent with the regulation." *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414, 65 S.Ct. 1215, 1217, 89 L.Ed. 1700 (1945).

The Supreme Court also interpreted the statutory and regulatory scheme as providing an independent right to indemnity. Moreover, the recognition of a loss to the guarantor merely because of a failure of the lender's rights against the principal is incompatible with the background of general surety laws against which the statute was drawn.... For these reasons, we are constrained to agree with the uniform construction of the lower courts, including that of the two courts below, that the statute affords an independent right of indemnity to the Veterans Administration. Finally, we find untenable respondent's argument that the applicable Regulation does not support recovery because there was no debt due from the veteran at the time of payment on the guaranty.... The Regulation is merely declaratory of a surety's customary right of indemnity for amounts paid pursuant to an obligation of the guarantor assumed with the consent of the principal. This right is in general unaffected by defenses of the principal which are not available to the guarantor. *United States v. Shimer*, 367 U.S. 374, 387-88, 81 S.Ct. 1554, 1562-63, 6 L.Ed.2d 908 (1961) (emphasis in original) (citing, inter alia, Decisions of the Administrator of Veterans' Affairs, No. 625 at 1154). See also *United States v. Rossi*, 342 F.2d 505, 506 (9th Cir.1965); *McKnight v. United States*, 259 F.2d 540, 543 (9th Cir.1958).

In reaching this conclusion, the Court noted, "Relief from liability in these circumstances would convert a guaranty into a grant of aid. But the entire history of the 'home loan' provisions of the statute is inconsistent with an intent to make outright grants, rather than loans of cash or credit, to returning servicemen." *Shimer*, 367 U.S. at 387, 81 S.Ct. at 1562 (citation omitted). The VA therefore argues that this history establishes a right of indemnity which is unaffected by any state foreclosure law.
The VA finds additional support in the loan documents. The form warns that, unless the veteran follows established procedures for transferring the loan, he will remain liable on the note and must "repay any guaranty claim which the VA may be required to pay your lender on account of default in your loan payments. The amount of any such claim payment will be a debt owed by you to the Federal Government. This debt will be the object of established collection procedures." VA Form 26-1820; VA Form 26-1802a. The same documents state that they are governed by federal law. Thus, the VA claims that debtors are aware that they will be liable in case of default and will not be protected by state law.

Appellees argue that the statutory and regulatory schemes do not establish a right to indemnity independent of the VA's right to subrogation. The statute speaks expressly of subrogation and is silent as to indemnity. See 38 U.S.C.A. s 1832 (West Supp.1989). In addition, the regulation states that the veteran's debt arises from money paid by the Administrator "on account of the liabilities of any veteran." 38 C.F.R. s 36.4323(e); cf. VA Form 26- 1820; VA Form 26-1802a. Because a non-judicial foreclosure sale satisfies the debtor's obligations to the lender under Washington law, appellees argue that here, the VA's obligation to the lender does not arise from any liability of the debtor.

Appellees point to 38 C.F.R. s 36.4323(f) as further support. This regulation releases the VA from any obligation to the lender if the lender releases the debtor from personal liability. As appellees argue, the VA would not need to prevent the lender

from impairing the VA's rights if the VA indeed possessed an independent indemnity right.

In addition, appellees argue that the loan documents do not fairly warn veterans that in the event of foreclosure they may be liable for an amount greater than the amount that would be owed under state law. First, the document states that established collection procedures will be used--implying that in the event of foreclosure the VA will look to state law remedies. See VA Form 26-1820; VA Form 26-1802a. Second, the warning applies to assumption of loans, not foreclosures. Id. However, the documents do imply a foreclosure situation, albeit with a third party who has improperly assumed the loan. Id.
Given *Shimer* and its progeny, appellees' arguments are not persuasive. Courts have consistently interpreted 38 C.F.R. s 36.4323 as giving the VA a right to indemnity in addition to its statutory right to subrogation. *Shimer*, 367 U.S. at 387-88, 81 S.Ct. at 1562-63 (citing, inter alia, Decisions of the Administrator of Veterans' Affairs, No. 625 at 1154); *United States v. Rossi*, 342 F.2d 505, 506 (9th Cir.1965); *McKnight v. United States*, 259 F.2d 540, 543 (9th Cir.1958); 38 U.S.C.A. s 1832. Although the loan documents may be ambiguous as to the remedies available to the VA in the event of foreclosure, they unambiguously state that the loan terms are governed by the federal code and regulations. See VA Form 26-1820; VA Form 26-1802a. Federal regulations governing the loan give the VA a right to indemnity as well as a right to subrogation derived from the lender's claims. This does not mean, however, that the VA was free to exercise this right in the circumstances presented by this case.

B. The VA argues that its right to indemnity is independent of lenders' rights to collect deficiencies under Washington law and also displaces any state law which would preclude it from proceeding personally against the debtor. It relies on *United States v. Shimer*, 367 U.S. 374, 387-88, 81 S.Ct. 1554, 1562-63, 6 L.Ed.2d 908 (1961), *United States v. Rossi*, 342 F.2d 505, 506 (9th Cir.1965), and *McKnight v. United States*, 259 F.2d 540, 543

(9th Cir.1958). However, these cases are not dispositive in this case.

In *Shimer*, the Supreme Court reversed the Third Circuit's determination that a lender's failure to comply with a Pennsylvania statute barred the lender's claim against the debtor, and thus barred the VA's rights as well. 367 U.S. at 388, 81 S.Ct. at 1563. In upholding the VA's right to collect against the debtor, the Court found that federal law completely displaced the Pennsylvania law which the debtor asserted barred the lender's claim. Both the state statute and the federal regulations provided a detailed, comprehensive method of calculating the amount that the lender was required to set off against the VA's guaranty as a result of the foreclosure sale. The Court stated, "[T]he method of determining these credits is ... specified in the Regulations, indeed spelled out in s 36.4320 in such great detail that there can be little doubt of an administrative intent that such method should provide the exclusive procedure." Id. at 379, 81 S.Ct. at 1558 (citation omitted). The regulation at issue provided that the amount realized by the lender at the foreclosure sale was to be credited to its guaranty claim against the VA. Id. It further specifie[d] the way in which the Veterans' Administration can require the mortgagee to credit more than the amount received at the foreclosure sale and thereby protect itself against the very risk the Pennsylvania Deficiency Judgment Act was designed to alleviate--the risk of having to make good its guaranty simply because the mortgaged property is sold for an inadequate price at a judicial sale. Id. at 379, 81 S.Ct. at 1558. The regulation authorized the Administrator to specify a minimum bid price before the sale, which would also be the minimum amount which would be credited on the guaranty claim. Id. at 380, 81 S.Ct. at 1559. It gave the lender the option of selling any property it purchased at or below this minimum amount to the Veterans' Administration for the specified minimum amount. Id. at 380, 81 S.Ct. at 1559. If the Administrator did not specify a minimum amount, the lender was to credit the net proceeds of the sale against the guaranty. Id. The Court found that this complex, comprehensive scheme, while intended to remedy the same abuses at which the Pennsylvania

Deficiency Judgment Act is directed, is, of course, inconsistent with the Pennsylvania procedures which provide for a judicial determination of the amount to be credited against an outstanding debt and do not obligate the guarantor to purchase the mortgaged property at its judicially determined value. Id. at 380-81, 81 S.Ct. at 1559-60. Because of the inconsistency, the Court concluded, "We have no doubt that this regulatory scheme, complete as it is in every detail, was intended to provide the whole and exclusive source of protection of the interests of the Veterans' Administration as guarantor and was, to this extent, meant to displace inconsistent state law." Id. at 381, 81 S.Ct. at 1560 (emphasis added); see also *Fidelity Fed. Savings & Loan v. de la Cuesta*, 458 U.S. 141, 153, 102 S.Ct. 3014, 3022, 73 L.Ed.2d 664 (1982) ("[W]here Congress has not completely displaced state regulation in a specific area, state law is nullified to the extent that it actually conflicts with federal law.").

Unlike the regulation in *Shimer*, the regulations at issue here do not provide a scheme for foreclosure "complete in every detail." While the regulations provide for an independent right of indemnity, they do not establish specific foreclosure procedures. In contrast to the tightly woven regulation addressed in *Shimer*, the regulations addressing foreclosure procedures are a loose framework that takes its substance and specificity from applicable state or local laws. See, e.g., 38 C.F.R. ss 36.4315(b)(2), 36.4319, 36.4320, 36.4323(c). They therefore do not indicate an intent to displace applicable state law, as did the regulations in Shimer.

Also unlike the Pennsylvania statute addressed in *Shimer*, the state statutes at issue in this case do not actually conflict with the federal regulations. If lenders proceed by judicial foreclosure under Wash.Rev.Code Ann. s 61.12.040 (1961), they retain the right to seek a deficiency judgment. Wash.Rev.Code Ann. s 61.12.070 (1961). Because the VA is entitled to subrogation under federal law, the application of state law does not compromise the federal protection of the VA's ability to proceed personally against the debtor.

The VA argues that our interpretation of Shimer in *United States v. Rossi*, 342 F.2d 505, 506 (9th Cir.1965), enables it to choose the non-judicial foreclosure alternative under Washington law, but nevertheless proceed personally against the debtor by exercising its indemnity right under federal law. In *Rossi*, the veteran transferred his mortgage to a third party but remained liable on the note. Id. When the third party defaulted, the lender foreclosed without notifying the veteran. The VA then attempted to collect against the veteran, who argued that the failure to comply with state notice requirements precluded a judgment against it. Id. In finding the veteran liable for the deficiency, we stated, In United States v. Shimer, it was held that the procedures outlined in the regulations governing guaranty procedures were intended by Congress to provide a uniform system for determining the Administrator's obligation as guarantor and to displace state law in their operation, and that they provide an independent right of indemnity to the Veterans Administration, regardless of the failure of a lender's rights against the principal.... Thus the district court's conclusion that this action was one for a deficiency judgment to be governed by the notice and other provisions of California law cannot stand. Id. (citations omitted).

The *Rossi*, opinion did not point out a specific conflict between a state statute and a federal provision[5]. However, California, unlike Washington, precludes lenders from collecting deficiency judgments under any circumstances. See *Jones v. Turnage*, 699 F.Supp. 795, 799 (N.D.Cal.1988), appeal docketed, No. 89-15053 (9th Cir. Nov. 11, 1989); Cal.Civ.Proc.Code s 580b (West Supp.1990). The California scheme was therefore inconsistent with the federal regulation's protection of the VA's right to proceed personally against the debtor. For this reason,

---

[5]See *United States v. Whitney*, 602 F.Supp. 722, 727-28 n. 2 (W.D.N.Y.1985) (*Rossi* questioned for failing to point out any express conflict between state and federal law and "evidently proceeding on the assumption that federal preemption of this field was complete.").

under Shimer, the federal regulation displaced the state law of California, allowing the VA, through its independent indemnity right, to proceed against the debtor. In this case, on the other hand, it is possible for the lender to collect a deficiency under Washington law, by proceeding judicially.

The VA's participation in what is, in effect, a choice of remedy under Washington law further distinguishes this case from Rossi. In *Rossi*, the debtor protested that he did not receive notice of foreclosure as required by state law, and the VA was thus precluded from proceeding against him. 342 F.2d at 506. Yet the VA was not responsible for the lack of notice; the lender, proceeding against the third party in foreclosure, failed to notify the veteran debtor. Id. In contrast, the VA in this case affirmatively instructed Washington lenders to proceed by way of non-judicial foreclosure--choosing a path that precluded the collection of a deficiency under Washington state law.
McKnight v. United States, 259 F.2d 540 (9th Cir.1958), also involved California's antideficiency law. The VA sued a veteran to recover its loss after foreclosure on a federally guaranteed mortgage. The veteran claimed the action was one for a deficiency judgment, and was therefore precluded by California's antideficiency law. We found the VA's claim valid on the basis of its right to indemnity. There was a finding below that the facts of this case establish that defendant herein was sued on his independent contract of indemnity and not for any deficiency judgment. We need not determine whether West's Ann. California Code of Civil Procedure s 580b does or does not apply.... We rely on the general proposition that the subject matter of this litigation arises under the federal law and cannot be impaired by a state statute. Id. at 543-44.

Like *Rossi*, *McKnight*, is distinguishable in that the California law prevented the collection of a deficiency under any circumstances. While Cal.Civ.Proc.Code s 580b "impaired" the federal interest in protecting the VA, the Washington law at issue in this case does not. It provides a route whereby the VA can foreclose judicially and retain its right to proceed personally

against the debtor, consistent with both Washington and federal law.

Because it provides an alternative which allows the VA to exercise its primary right to subrogation and receive the full measure of protection without displacing state law, the Washington scheme is consistent with federal law. The federal regulations protect the VA's ability to collect deficiencies remaining after foreclosure by providing both a right to subrogation and a right to indemnity. 38 C.F.R. s 36.4323. The VA's primary right against the debtor is the statutory right to subrogation. When a state antideficiency law precludes collection by way of subrogation, the VA may exercise its independent indemnity right, which displaces the effect of state law. *Rossi*, 342 F.2d at 506; *McKnight*, 259 F.2d at 543.

Washington's two paths to foreclosure, see Wash.Rev.Code Ann. ss 61.12.040, 61.24.040 (1961 & Supp.1989); *Donovick v. Seattle-First Nat'l Bank*, 111 Wash.2d 413, 757 P.2d 1378, 1381 (1988) (Dore, J., dissenting), permit the VA to exercise its primary right to subrogation, proceed personally against the debtor, and be made completely whole. Thus, there is no need for the VA to resort to the right to indemnity provided in the federal regulations.

It is appropriate to adopt this consistent state scheme as the federal rule of decision. See *United States v. Kimbell Foods*, Inc., 440 U.S. 715, 728-29, 99 S.Ct. 1448, 1458-59, 59 L.Ed.2d 711 (1979). Because the VA directs the lender's choice between the two methods available in Washington, it is in complete control of its ability to be made whole. Given the availability of the judicial foreclosure alternative, which allows the VA to exercise its primary right to subrogation and proceed directly against the debtor, the VA may not choose the non-judicial foreclosure alternative, and then resort to its right to indemnity. The federal statutory and regulatory scheme contemplates reliance on state foreclosure procedures. Where state procedures preclude holding the debtor personally liable, the VA retains its right to do so by

way of indemnity. Where, as in the state of Washington, state foreclosure procedures afford the VA identical protections, there is no conflicting state law to displace.

C. Developments in the law subsequent to Shimer and Rossi support this result. The Supreme Court has acknowledged that federal regulations as well as federal statutes can preempt state law, but it has been reluctant to infer preemption solely from the comprehensiveness of a regulatory scheme. See *Hillsborough County v. Automated Medical Laboratories*, 471 U.S. 707, 717-18, 105 S.Ct. 2371, 2377, 85 L.Ed.2d 714 (1985); *Siuslaw Concrete Constr. Co. v. Washington Dep't of Transp.*, 784 F.2d 952, 957 (9th Cir.1986). Rather, state laws remain effective if consistent with federal legislation. See Hillsborough, 471 U.S. at 713, 105 S.Ct. at 2375. As in *Hillsborough* and *Siuslaw*, the state legislation at issue in this case does not directly conflict with the federal provisions.

In the context of other federal lending programs, this circuit has become increasingly protective of states' interests in applying antideficiency laws. Early cases rejected the application of state laws[6]. However, in *United States v. MacKenzie*, 510 F.2d 39 (9th Cir.1975) (en banc), we upheld the application of a state antideficiency law in foreclosure on a Small Business Administration (SBA) loan. While we did not expressly overrule

---

[6]In *United States v. Stadium Apartments*, 425 F.2d 358 (9th Cir.), cert. denied, 400 U.S. 926, 91 S.Ct. 187, 27 L.Ed.2d 185 (1970), we held that a state redemption law did not apply upon foreclosure by the Federal Housing Authority (FHA) of a mortgage it guaranteed. See id. at 362 (citing *Shimer*, 367 U.S. 374, 81 S.Ct. at 1554; *Rossi*, 342 F.2d 505; *McKnight*, 259 F.2d at 543-44). In *Branden v. Driver*, 441 F.2d 1171 (9th Cir.1971), we relied on *Stadium Apartments* and found that California's antideficiency law did not bar federal collection of a deficiency remaining after foreclosure of a VA loan.

Stadium Apartments, see id. at 42 n. 4, we distinguished it on the ground that SBA loans were individually negotiated, unlike the form FHA and VA loans in *Stadium Apartments* and *Branden*, respectively. Id. at 42.

We subsequently held state laws providing debtors rights of redemption and defenses to claims arising from default applicable to SBA loans. See *Great Southwest Life Ins. Co. v. Frazier*, 860 F.2d 896 (9th Cir.1988) (upholding debtor's right to assert defense provided by Idaho law to SBA's claims against her); Dupnik v. United States, 848 F.2d 1476 (9th Cir.1988) (upholding application of Arizona redemption rights upon foreclosure of SBA loan); *United States v. Crain*, 589 F.2d 996, 999-1000 (9th Cir.1979) (upholding debtors' right to assert defense provided by Arizona law to SBA's claim against them and citing MacKenzie, 510 F.2d at 41-42); see also *United States v. Ellis*, 714 F.2d 953 (9th Cir.1983) (upholding application of Washington law providing for redemption rights in foreclosure on Farmers Home Administration loan). In *United States v. Stewart*, 523 F.2d 1070 (9th Cir.1975), a case involving an individually-negotiated VA loan,[7] we followed MacKenzie and held that the California law applied to prevent collection of a deficiency.[8] Id. at 1072.

---

[7]The parties struck out a paragraph on the standard VA loan form, which read, in part: "Title 38, United States Code and the Regulations issued thereunder shall govern the rights, duties and liabilities of the parties hereto...." They retained the paragraph which stated, "This Deed shall be construed according to the laws of the State of California." *Stewart*, 523 F.2d at 1071-72.

[8]In both *Stadium Apartments* and *Stewart*, we emphasized the individual character of the loans at issue. We subsequently rejected the argument that this factor was dispositive, stating that "individual negotiation is not critical to our determination...." *Ellis*, 714 F.2d at 957 (citing Crain, 589 F.2d at 1000).

These cases evidence this court's increased willingness to recognize the application of state law in the context of federal programs. The shift in our analysis has been prompted, to some degree, by the Supreme Court's decision in *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 728-29, 99 S.Ct. 1448, 1458-59, 59 L.Ed.2d 711 (1979)[9]. In *Kimbell Foods*, the Court held that in some circumstances, state law provides the appropriate federal rule for decision. When no distinct federal statute or properly promulgated regulations apply and displace existing state law, the courts 1371 must decide either to adopt state law or to fashion a federal rule, looking to: "(1) whether the issue requires 'a nationally uniform body of law'; (2) 'whether application of state law would frustrate specific objectives of the federal programs'; and (3) whether 'application of the federal rule would disrupt commercial relationships predicated on state law.' " *Mardan Corp. v. C.G.C. Music, Ltd.*, 804 F.2d 1454, 1458 (9th Cir.1986) (quoting *Kimbell Foods*, 440 U.S. at 728-29, 99 S.Ct. at 1458-59). Applying the *Kimbell Foods* test in this case demonstrates that the Washington foreclosure law is the appropriate federal rule of decision for VA loans made in that state.

The VA argues that the VA loan guaranty program is national in scope and provides uniform procedures, including uniform guaranty agreements. However, the VA regulations themselves contemplate application of state law to foreclosure procedures. See 38 C.F.R. ss 36.4315(b)(2), 36.4319, 36.4320, 36.4323(c); *United States v. MacKenzie*, 510 F.2d 39, 43 (9th Cir.1975) (Ely, J., and Browning, J., concurring). Cf. *Kimbell Foods*, 440 U.S. at 730-31, 99 S.Ct. at 1459-60. Because federal law does not

---

[9]*Great Southwest*, 860 F.2d at 900, and *Dupnik*, 848 F.2d at 1479, both explicitly utilized a *Kimbell Foods* analysis. *Crain*, 589 F.2d at 999-1000, did not cite *Kimbell Foods*, but used a similar analysis in concluding that the Arizona law should be adopted as the federal rule of decision.

provide a federal foreclosure procedure, but rather relies upon foreclosure procedures under various state statutes, it appears that Congress saw no need for "a nationally uniform body of law."[10] Id. at 728, 99 S.Ct. at 1458.

Adopting the Washington law does not "frustrate specific objectives of the federal program." Id. The remedy provided by the federal statute is subrogation, which allows the VA to pursue whatever rights a lender has, including proceeding personally against debtors to collect deficiencies remaining after foreclosure. 38 U.S.C.A. s 1832. To protect the VA's right to proceed personally against the debtor when state antideficiency laws bar collection through subrogation, the federal regulations provide for an additional right to indemnity. 38 C.F.R. s 4323(e). When the VA is unable to exercise its primary right to subrogation, the right to indemnity granted by the regulations comes into play. The Washington law provides a foreclosure method under which the VA may exercise its primary right to subrogation and obtain the

---

[10]In the Veterans' Benefits Amendments of 1989, Pub.L. No. 101-237, s 304, 103 Stat. 2062, 2073 (to be codified at 38 U.S.C. s 1803), Congress provided a uniform national rule for the collection of deficiency judgments. For loans closed after December 31, 1989, veterans are not liable for deficiencies resulting from default in the absence of fraud, misrepresentation, or bad faith. Id. This change reflects Congress' recognition that, under the former legislation, the various state schemes applied, with varying results as to the collection of deficiency judgments. Although Congress apparently has decided that a uniform federal rule is necessary prospectively, the fact that it did not make the new legislation retroactive implies that under the legislation applicable in this case, it did not see a pressing need for a uniform federal rule.

full protection available under the federal statute.[11] Adopting this law as the federal rule of decision, then, does not frustrate federal objectives.

The VA claims that forcing it to elect judicial foreclosure will increase its administrative costs. "The fact that increased costs may result from the adoption of state law regarding debtor and creditor rights is not controlling. Both the Supreme Court and this court have adopted state law despite added costs to loan programs when state law did not jeopardize other federal interests." *United States v. Ellis*, 714 F.2d 953, 955 (9th Cir.1983) (citing *Kimbell Foods*, 440 U.S. at 740, 99 S.Ct. at 1464; *Yazell v. U.S.*, 382 U.S. 341, 352-57, 86 S.Ct. 500, 506-09, 15 L.Ed.2d 404 (1966); *Crain*, 589 F.2d at 999-1000; *MacKenzie*, 510 F.2d at 42). Indeed, the VA has instructed lenders in Washington to proceed by way of judicial foreclosure during the pendency of this suit.[12]

Allowing the VA to ignore Washington law "would disrupt commercial relationships predicated on state law." *Kimbell Foods*,

---

[11]The California law at issue in *Jones v. Turnage*, 699 F.Supp. 795, 799 (N.D.Cal.1988), appeal docketed, No. 89-15053 (9th Cir. Nov. 11, 1989), did not give the VA this choice. See Cal.Civ.Proc.Code s 580b (West Supp.1990).

[12]The veterans also argue that Congress' abrogation of the VA's right to collect deficiencies in the amendments is evidence that the funds raised by these collections are neither critical nor substantial. See Veterans' Benefits Amendments of 1989, Pub.L. No. 101-237, s 304, 103 Stat. 2062, 2073 (to be codified at 38 U.S.C. s 1803). However, the new legislation is more accurately read as a trade-off: the VA gives up its right to collect deficiencies, and, in exchange, the veterans pay higher loan fees. See id. at s 303, 103 Stat. at 2071-73 (to be codified at 38 U.S.C. s 1829).

440 U.S. at 729, 99 S.Ct. at 1459. In adopting the dual foreclosure scheme, the Washington legislature balanced the debtors' and lenders' rights. See *Donovick v. Seattle-First Nat'l Bank*, 111 Wash.2d 413, 757 P.2d 1378, 1379- 80 (1988) (en banc). "Non-judicial foreclosure obviously provides significant advantages to a creditor seeking to liquidate security for a defaulted loan; these advantages have been conferred by the legislature in return for the creditors' relinquishment of the right to obtain a deficiency judgment." *United States v. Vallejo*, 660 F.Supp. 535, 538 (W.D.Wash.1987). Allowing the VA to instruct lenders to foreclose non-judicially under Washington law, and then use its federal right to indemnity to override the consequences of that instruction, circumvents the balance the state legislature intended in designing and adopting the two foreclosure options.

Conclusion

Although we disagree with the district court's determination that the VA has no right to indemnity, the court correctly held that the VA may not proceed personally against the debtor when it instructs the lender to foreclose nonjudicially under Washington law. Because the Washington scheme is consistent with the federal statutes and regulations, we adopt it as the federal rule of decision. The remedies available to the VA through judicial foreclosure were consistent with federal objectives. The VA, however, chose to instruct lenders to proceed by non-judicial foreclosure, and it was bound by the results of that choice as mandated by the federal rule of decision.

AFFIRMED.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

DALE L. CARTER, DAVID A., JOHNSON, FRED EMERY, and JAMES R. STRAW, on behalf of all in the State of Idaho similarly situated,	
Plaintiffs,	MEMORANDUM OF OPINION ON CROSS-MOTIONS FOR SUMMARY JUDGMENT
vs.	
EDWARD DERWINSKI, or his successor, Secretary of the Department of Veterans Affairs,	
Defendant.	

Civ. No. 88-1426.
United States District Court,
D. Idaho.
Feb. 28, 1991.

M. Michael Sasser, Hamlin & Sasser, P.A., Boise, Idaho, Margaretta Eakin, Margaretta Eakin, P.C., Portland, Or., David A. Leen, Leen & Moore, Seattle, Wash., for plaintiffs.

Maurice O. Ellsworth, U.S. Atty., D. Marc Haws, Asst. U.S. Atty., Boise, Idaho, Stuart M. Gerson, Asst. Atty. Gen., J. Christopher Kohn, Robert M. Hollis, Ruth A. Harvey, Dept. of Justice, Washington, D.C., for defendant.

RYAN, Chief Judge.

APPENDIX B

I. FACTS AND PROCEDURE

Plaintiffs Dale Carter, David Johnson, Fred Emery, and James Straw[1] (hereinafter collectively referred to as "veterans") bought homes in Idaho through the Veterans Administration (VA) loan guaranty program. The veterans defaulted on their VA guaranteed loans which were secured by trust deeds. Upon default, the private lenders foreclosed. Apparently, the mortgaged properties were sold for less than the outstanding balances on the loans and deficiencies were left. Pursuant to its guarantee with the mortgagees, the VA reimbursed the lenders for such deficiencies and then turned to the defaulting veterans to recover the amounts paid on the deficiencies.

On December 30, 1988, plaintiffs filed their original complaint herein pursuant to Idaho Code s 45-1512[2], requesting

---

[1]James R. Straw was not named in the original complaint; however, pursuant to this court's order allowing amendment, Plaintiffs' First Amended Complaint for Declaratory Judgment, Mandamus, Injunctive and Monetary Relief was filed on July 24, 1990, and Mr. Straw was added as a named party. The amended complaint is identical to the original complaint in all other respects, and defendants' original Answer was deemed an answer to the amended complaint. See Order Granting Motion to Amend, filed July 17, 1990.

[2]Idaho Code s 45-1512 (1977) states: Money judgment--Action seeking balance due on obligation.--At any time within 3 months after any sale under a deed of trust, as hereinbefore provided, a money judgment may be sought for the balance due upon the obligation for which such deed of trust was given as security, and in such action the plaintiff shall set forth in his complaint the entire amount of indebtedness which was secured by such deed of trust and the amount for which the same was sold and the fair market value at the date of sale, together with interest from such

this court to enjoin the VA from collecting deficiencies and to compel the VA to return funds previously collected or withheld from themselves and/or other veterans. In simple terms, the veterans maintain that the VA should be precluded from collecting deficiencies wherever it failed to reduce its claim to a judgment within three months of a foreclosure sale as required under the Idaho Code.

The veterans originally named the Administrator of the VA, the United States of America, and the Veterans Administration as defendants. However, at a hearing on all pending motions conducted by this court on February 5, 1991, plaintiffs' counsel conceded that only Edward J. Derwinski, or his successor, as Secretary of the Department of Veterans Affairs should be named as a defendant in this action. Accordingly, finding that the "United States of America" and "the Veterans Administration" should be dismissed as parties to this action, this court granted defendants' motion to dismiss.[3]

The VA's Answer asserts, *inter alia*, the following affirmative defenses: (1) that the federal statute of limitations, 28 U.S.C. s 2415(a), applies to this action; (2) that Idaho Code s

---

date of sale, costs of sale and attorney's fees. Before rendering judgment the court shall find the fair market value of the real property sold at the time of sale. The court may not render judgment for more than the amount by which the entire amount of indebtedness due at the time of sale exceeds the fair market value at that time, with interest from date of sale, but in no event may the judgment exceed the difference between the amount for which such property was sold and the entire amount of indebtedness secured by the deed of trust.

[3]Hereinafter, for purposes of simplicity, reference shall be made to the VA when referring to the defendant.

45-1512 does not apply to an action based on the VA's right to indemnity; (3) even if Section 45-1512 did apply, plaintiffs' use of that statute in this action is improper because the statute should only be used as an affirmative defense and should not be used to preclude the VA from collecting the deficiencies through administrative channels; and (4) some of the debts of veterans may already have been reduced to final judgment in the United States District Court, and relief on those claims is barred by the doctrine of *res judicata*.

Following the hearing held on February 5, 1991, this court took the parties' cross-motions for summary judgment under advisement. Now, having fully considered the memoranda, affidavits and exhibits in the record, along with the oral arguments of counsel, those motions shall be ruled upon.

II. PENDING MOTIONS

A. *Cross-Motions for Summary Judgment*

1. Defendant's Motion for Summary Judgment.

The government filed a motion for summary judgment which requests this court to find that Idaho Code s 45-1512 does not bar the VA from collecting deficiencies because the six-year federal statute of limitations, 28 U.S.C. s 2415(a), applies; moreover, the VA has an independent right to indemnity which should not be affected by the Idaho statute. The VA also argues that Idaho Code s 45-1512 cannot serve as a basis for plaintiffs' claims in this action, because that section can only serve as an affirmative defense if the government were to bring actions against the plaintiffs and does not prohibit the government from collecting debts administratively.

2. Plaintiffs' Cross-Motion for Summary Judgment.

Plaintiffs seek a declaration that federal law incorporates Idaho Code s 45-1512, which governs the assertion of deficiency

judgments, and that, whether as subrogee to the rights of the guaranteed note holders or pursuant to an "indemnity" claim, the VA's collection activities are illegal. Plaintiffs seek, *inter alia*, to enjoin the VA from all collection activities related to the collection of such deficiencies and to require the VA to return all funds collected in violation of Section 45-1512.

3. Analysis of Cross-Motions for Summary Judgment.

(a) *The VA loan program.*

The Department of Veteran Affairs provides housing assistance to veterans by guaranteeing home loans made to veterans by private lenders. See generally 38 U.S.C.A. ss 1801-33 (West 1979 & Supp.1989); 38 C.F.R. Part 36 (1989). A brief summary of the procedures is helpful in considering the issues before the court.

If a veteran defaults on a loan, the lender must give the VA 30 days' notice before foreclosing. 38 C.F.R. s 36.4317. The VA then has 15 days in which to give the lender instructions related to such proceedings. 38 C.F.R. s 36.4324(f). Apparently, however, the VA does not participate in the actual foreclosure proceeding, unless the lender is not reasonably diligent. 38 C.F.R. s 36.4319(f).

Once a foreclosure sale has taken place, the VA must reimburse the lender for certain remaining losses. 38 C.F.R. s 36.4321. According to federal regulations, the VA may then recover from the veteran the amount the VA paid to the lender. 38 C.F.R. s 36.4323(a), (e) (any amounts paid by the VA on account of liabilities of the veteran "constitute a debt owing to the United States" by the veteran); VA Form 26-1820; VA Form 26-1802a. Significantly, however, rather than establishing a federal foreclosure proceeding, the relevant federal statutes and regulations contemplate foreclosure under state or local law. See e.g., *Whitehead v. Derwinski*, 904 F.2d 1362, 1364 (9th

Cir.1990) (citing 38 U.S.C.A. ss 1820(a)(6), 1832; 38 C.F.R. ss 36.4319, 36.4320).

(b) *The Impact of Whitehead v. Derwinski.*

In a recent decision, the Ninth Circuit Court of Appeals acknowledged that "[f]ederal law governs the guaranty agreement between the veteran and the VA." *Id.* at 1364 (*citing* VA Form 26-1820, VA Form 26-1802a). However, in affirming the district court, the Ninth Circuit went on to explain the following:

> The remedy provided by the federal statute is subrogation, which allows the VA to pursue whatever rights a lender has, including proceeding personally against debtors to collect deficiencies remaining after foreclosure. 38 U.S.C.A. s 1832. To protect the VA's right to proceed personally against the debtor when state antideficiency laws bar collection through subrogation, the federal regulations provide for an additional right of indemnity. 38 C.F.R. s 4323(e). When the VA is unable to exercise its primary right to subrogation, the right to indemnity granted by the regulations comes into play.

Whitehead v. Derwinski, 904 F.2d at 1371.

The VA would certainly like this court to conclude that since it's too late for the VA to proceed under Section 45-1512 via its right to subrogation, its right to indemnity should come into play. However, in Idaho, as in the State of Washington, had the VA proceeded in accordance with Idaho Code s 45- 1512, or had the VA instructed the lenders involved how to proceed under Section 45-1512, the VA could have fully protected itself from this situation.

The VA argues that the VA loan guaranty program is national in scope and provides uniform procedures, including uniform guaranty agreements. However, as discussed in *Whitehead*, the

VA regulations themselves contemplate application of state law to foreclosure procedures. *Whitehead v. Derwinski*, 904 F.2d at 1371 (citing 38 C.F.R. ss 36.4315(b)(2), 36.4319, 36.4320, 36.4323(c); *United States v. MacKenzie*, 510 F.2d 39, 43 (9th Cir.1975); *Cf. United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 730-31, 99 S.Ct. 1448, 1459-60, 59 L.Ed.2d 711 (1979)). Indeed, as the Ninth Circuit affirmed the finding that the VA's rights against veterans could not exceed the lender's rights under the Washington foreclosure statutes, the Court of Appeals expressly concluded that: "Because federal law does not provide a federal foreclosure procedure, but rather relies upon foreclosure procedures under various state statutes, it appears that Congress saw no need for 'a nationally uniform body of law.' " *Whitehead v. Derwinski*, 904 F.2d at 1371 (citing *United States v. Kimbell Foods, Inc.*, 440 U.S. at 728, 99 S.Ct. at 1458). As in *Whitehead*, adopting Idaho statute s 45-1512 as the federal rule of decision in this district would not frustrate specific objectives of the VA loan guaranty program.

"Non-judicial foreclosure obviously provides significant advantages to a creditor seeking to liquidate security for a defaulted loan; these advantages have been conferred by the legislature in return for the creditors' relinquishment of the right to obtain a deficiency judgment." *Whitehead v. Derwinski*, 904 F.2d at 1372, (quoting *United States v. Vallejo*, 660 F.Supp. 535, 538 (W.D.Wash.1987). Maintaining that Section 45-1512 was enacted to protect debtors like themselves, the veterans contend that to allow the VA to permit lenders to foreclose nonjudicially under Idaho law, and then use the federal right to indemnity to collect the deficiencies anyway, would go against the holding in Whitehead.[4]

---

[4]Consistent with these arguments is the case of *United States v. Vallejo*, 660 F.Supp. 535 (W.D.Wash.1987), in which the VA was precluded from recovering a deficiency under principles of indemnity based on the following: The Government is attempting to stretch its rights as a surety beyond the underlying obligation of

Moreover, the *Whitehead* opinion is entirely consistent with recent Congressional legislation aimed at holding good faith veterans unaccountable for deficiencies resulting from non-judicial foreclosures. On December 18, 1989, President Bush signed into law the Veterans' Benefits Amendments Act of 1989. Public Law 101-237, 1989 U.S.Code Cong. & Admin.News (103 Stat.) 2062. The Act states with respect to VA loans closed after December 31, 1989, that veterans shall not be liable for any deficiency unless there is "fraud, misrepresentation or bad faith." *Accord Vail v. Derwinski*, 742 F.Supp. 1039 (D.Minn.1990).

The Ninth Circuit Court of Appeals affirmed *Whitehead v. Derwinski* in June 1990, and this court gave the parties herein an opportunity to address the impact of *Whitehead* on their respective positions. The VA placed great emphasis on the fact that *Whitehead* pertains to a Washington statute, which differs from Idaho Code s 45-1512. Notwithstanding the fact that neither *Whitehead* nor any other case speaks about a statute identical to Idaho Code s 45-1512, this court is compelled to conclude that the

---

the debtor as principal to the holder of the guaranteed note. As the language of section 4323(e) indicates, the defendant is an indemnifier for any amounts paid "on account of the liabilities" of the veteran; where the VA as surety fails to require the note holder to foreclose judicially in order to preserve the principal's personal liability ... any payments in excess of the amount bid at the trustees' sale are not payments on account of the liabilities of the veteran. *Id.* at 539 (footnote omitted) (emphasis added). In support of its holding, the district enunciated the reasoning of the Supreme Court which acknowledged that this regulation was expressly amended to substitute the phrase "on account of the liabilities of any veteran" for the earlier language, "pursuant to the guaranty." Id. (citing *United States v. Shimer*, 367 U.S. 374, 388, 81 S.Ct. 1554, 1563, 6 L.Ed.2d 908 (1961)).

analysis in *Whitehead* goes far beyond issues arising within the borders of the State of Washington.

Indeed, the Ninth Circuit specifically addressed national trends in the law as it reached the conclusion that the VA should be barred from collecting deficiencies where it failed to comply with the applicable Washington statutes. Therefore, based on the reasoning in *Whitehead* and in the wake of several decisions addressing similar issues[5], it appears that for the VA to have preserved its right to recover via subrogation or indemnity, Idaho Code s 45-1512 required the VA (and/or the lenders involved) to seek a deficiency judgment within three months of any foreclosure sales that took place in Idaho.

(c) *The cases of Shimer and Jones.*

In support of its position, the VA directs this court's attention to *United States v. Shimer*, 367 U.S. 374, 81 S.Ct. 1554, 6 L.Ed.2d 908 (1961), and *Jones v. Turnage*, 699 F.Supp. 795 (N.D.Cal.1988). In both cases, veterans were liable to the VA for deficiency amounts paid by the VA to lenders despite the fact that state laws precluded the lenders from recovering such deficiencies directly from the veterans. However, a full reading of these cases in light of *Whitehead* and recent cases from other jurisdictions indicates that the VA's reliance on these cases is misplaced. Both cases are distinguishable from the case at bar and from *Whitehead*.

---

[5]See *United States v. Church*, 736 F.Supp. 1494, 1497 (N.D.Ind.1990) (VA barred from collecting deficiency from veteran where the VA was not required to pay the lender for deficiency); *Vail v. Derwinski*, 742 F.Supp. 1039, 1041 (D.Minn.1990) (where a lender has no right to collect a deficiency via a non-judicial foreclosure, the VA has none either); *United States v. Davis*, 756 F.Supp. 1162 (E.D.Wis.1991) (VA precluded from seeking a deficiency under right to indemnity where lender pursued a non-judicial foreclosure).

In *Shimer*, the United States sued a veteran to recover the amount the VA had paid to the lender upon the veteran's default. However, to the extent the Supreme Court discussed conflicts between state law and federal regulations, the crux of the decision in *Shimer* was that *federal* law should control the amount of money which the VA should pay *lenders*. *United States v. Shimer*, 367 U.S. at 377-81, 81 S.Ct. at 1557-60. See also *United States v. Davis*, 756 F.Supp. 1162, 1164 (E.D.Wis.1991). The reasoning in Shimer is not inconsistent with a finding that deficiencies owing from veterans must be determined under state laws, such as those in Washington or Idaho. Therefore, *Shimer* does not, and should not, defeat the claims of the plaintiffs in the case at bar.

Jones is also distinguishable from the case at bar. In *Jones*, the VA was permitted to exercise its right to seek indemnity from veterans even though lenders were completely precluded by California's antideficiency law from directly recovering any deficiencies remaining after foreclosure sales. *Jones*, however, lends no support to the VA's position in the case at bar because, as noted in *Whitehead*, "California [law], unlike Washington [or Idaho], precludes lenders from collecting deficiency judgments under any circumstances." *Whitehead v. Derwinski*, 904 F.2d at 1368 (citing *Jones v. Turnage*, 699 F.Supp. at 799, appeal docketed, No. 89-15053 (9th Cir. Nov. 11, 1989); Cal.Civ.Pro.Code s 580b (West Supp.1990)) (emphasis added).

(d) *Idaho Code s 45-1512 not a statue of limitation operating in contravention of 28 U.S.C. s 2415(a).*

Throughout this proceeding, the VA attempts to shift this court's focus from the overall analysis in *Whitehead* to the three-month period delineated in Idaho Code s 45-1512. Notwithstanding such attempts, however, this court finds that *Whitehead* requires this court to focus on the direction given by the VA to its lenders at the time the veterans defaulted on their VA guaranteed loans. Hence, the three-month period in the Idaho

statute only bears tangentially on the claims asserted by the veterans in this case.

Moreover, this court finds the VA's position regarding the three-month time frame to be attenuated by the federal statutory and regulatory scheme under which the VA loan program is administered. The VA certainly cannot contend that the three-month time frame for seeking a deficiency judgment under the Idaho Statute is any more onerous than the federal regulations which establish procedures to be followed upon default. For instance, 38 C.F.R. s 36.4317 provides that, upon default, the lender must give the VA 30 days' notice before foreclosing. *Whitehead v. Derwinski*, 904 F.2d at 1364. Thereafter, 38 C.F.R. s 36.4324(f) provides that the VA has 15 days in which to give the lender instructions regarding such proceedings. *Id.*
While the VA attempts to overcome its failure to comply with Section 45-1512 pursuant to the six-year statute of limitation provided under 28 U.S.C. s 2415(d), the analysis in *Whitehead* simply does not support such a conclusion. Indeed, nothing in the record suggests that the VA was unable to comply with Idaho Code s 45-1512 had it chosen to do so. And, in the event the VA had directed the lenders involved to comply with Section 45-1512, and had the lenders refused to follow such direction, then the veterans would have been released from personal liability and the VA would not have been required to pay lenders involved as guarantor of the mortgage notes. Accord *United States v. Church*, 736 F.Supp. 1494, 1497-99 (N.D.Ind.1990); *United States v. Davis*, 756 F.Supp. 1162, 1165 (E.D.Wis.1991).

Put simply, the veterans herein are entitled to no less protection than the veterans in *Whitehead*. The VA cannot be permitted to overlook such statutory protections and then, long after default and foreclosure have taken place, rely on its indemnity rights to pursue collection activities against veterans. Thus, in failing to have directed the lenders involved to follow the Idaho foreclosure procedures, the VA failed to preserve the rights of such lenders, and of the VA, to obtain deficiency judgments on the defaulted VA guaranteed loans.

(e) *Conclusion on cross-motions for summary judgment.*

Based on the foregoing discussion and the standard for granting summary judgment under Rule 56 of the Federal Rules of Civil Procedure, this court is compelled to find that the VA's Motion for Summary Judgment should be denied and that plaintiffs' motion for summary judgment should be granted.

III. ORDER

Based on the foregoing and the court being fully advised in the premises,

IT IS HEREBY ORDERED:

1. That defendants' Motion to Dismiss the United States of America and the Veterans Administration as named parties should be, and is hereby, GRANTED; accordingly, the parties shall conform the caption of all future pleadings filed herein to the caption set forth at the outset of this order.

2. That plaintiffs' cross-motion for summary judgment should be, and is hereby, GRANTED.

3. That defendant's Motion for Summary Judgment should be and is hereby, DENIED.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

DALE L. CARTER, DAVID A., JOHNSON, FRED EMERY, and JAMES R. STRAW, on behalf of all in the State of Idaho similarly situated,	)
Plaintiffs,	)
vs.	)
EDWARD DERWINSKI, or his successor, Secretary of the Department of Veterans Affairs,	)
Defendant.	)

No. 91-35530.
United States Court of Appeals,
Ninth Circuit.
Argued and Submitted En Banc Sept. 24, 1992.

Malcolm L. Stewart, U.S. Dept. of Justice, Washington, DC, for defendant-appellant.

David A. Leen, Leen & Moore, Seattle, Washington, Margaretta Eakin, Portland, OR, for plaintiffs-appellees.

Appeal from the United States District Court for the District of Idaho.

Before: HUG, FLETCHER, FARRIS, D.W. NELSON, BEEZER, BRUNETTI, KOZINSKI, NOONAN, THOMPSON, LEAVY and TROTT, Circuit Judges.

APPENDIX C

KOZINSKI, Circuit Judge:

We took this case en banc to consider whether *Whitehead v. Derwinski*, 904 F.2d 1362 (9th Cir.1990), should remain the law of the circuit.

Background

In recognition of the debt we owe the men and women who have served in our country's armed forces in time of conflict, the Department of Veteran's Affairs ("VA") offers them home loan guarantees on terms substantially more favorable than those prevailing in the market. See generally 38 U.S.C. ss 3701-3733. When a veteran takes advantage of the VA guarantee program, two legal relationships are established, both of which are governed by federal law. First, the VA promises to reimburse the lender if the veteran defaults, up to the face value of the guarantee. 38 C.F.R. s 36.4321. Second, the veteran promises to reimburse the VA for any amount the VA pays the lender. Id. s 36.4323(e). This is an obligation owed directly to the VA, which it may recover by subrogating itself to any remaining rights of the lender, id. s 36.4323(a), or by pursuing an independent right of indemnity against the veteran, id. s 36.4323(e).

In the event of default, the lender must follow the VA's instructions, if any, as to the appropriate method and timing of foreclosure. Id. s 36.4324(f). Foreclosure of the property is to be done in accordance with state law. See 38 U.S.C. s 3720(a)(6). Idaho, like many other states, has a two-tier foreclosure scheme. One option is judicial foreclosure, which requires a judicial determination of the fair market value of the property, to protect the debtor from an unfairly low appraisal. Idaho Code ss 6-101 et seq. The lender may then seek a deficiency judgment for any remaining amount. Alternatively, a lender may foreclose nonjudicially by selling the property on the open market. Id. ss 45-1502 et seq. Nonjudicial foreclosures are easier and faster for

the lenders than judicial ones. Deficiency judgments are still permitted after nonjudicial foreclosure, but only if a fair market value determination is sought within three months of foreclosure. Id. s 45-1512. After that, no further judgments may be collected. See *Tanner v. Shearmire*, 115 Idaho 1060, 1063, 772 P.2d 267, 270 (Ct.App.1989).

Plaintiffs are Idaho veterans who defaulted on their guaranteed loans. They brought a class action to enjoin the VA from collecting deficiency judgments against them following nonjudicial foreclosure where the lender fails to obtain a fair market valuation within three months; they also sought the return of monies previously collected in this manner. On cross-motions for summary judgment, the district court held that the VA had forfeited its right to recover from the veterans. See *Carter v. Derwinski*, 758 F.Supp. 603 (D.Idaho 1991). Relying on our decision in *Whitehead v. Derwinski*, 904 F.2d 1362 (9th Cir.1990), the court held that the VA's primary right of subrogation had been lost through its failure to obtain a fair market valuation after its election of nonjudicial foreclosure. 758 F.Supp. at 608. The court therefore entered judgment for the veterans.

The VA appealed, and a three-judge panel of this court heard oral argument. Recognizing a potential conflict between *Whitehead* and *United States v. Shimer*, 367 U.S. 374, 81 S.Ct. 1554, 6 L.Ed.2d 908 (1961), the panel withdrew submission; a majority of the nonrecused regular active judges then voted to hear the case en banc, 970 F.2d 662 (9th Cir.1992).

Discussion

A. *Whitehead v. Derwinski* involved the Washington foreclosure scheme, which is similar to Idaho's. Like Idaho, Washington allows both judicial and nonjudicial foreclosures. Washington permits deficiency judgments after a judicial foreclosure, Wash.Rev.Code Ann. s 61.12.040, but prohibits them

altogether after a nonjudicial foreclosure, id. ss 61.24.040, 61.24.100. Because judicial foreclosure is much more cumbersome, the VA instructed Washington lenders to foreclose nonjudicially. *Whitehead*, 904 F.2d at 1364. Nonetheless, the VA tried to assert its right of indemnity against the veterans; the veterans sued to prevent the VA from collecting. We held that Washington's prohibition against deficiency judgments after nonjudicial foreclosure wasn't preempted by the VA regulations providing for subrogation and indemnity, and that the VA had lost its right to a deficiency judgment against the veterans.

In so holding, we first decided that the VA possesses a direct right of indemnity independent of its derivative right of subrogation: "Federal regulations governing the loan give the VA a right to indemnity as well as a right to subrogation derived from the lender's claims." 904 F.2d at 1367 (emphasis added). Consistent with this independent right of indemnity, Whitehead recognized that a state law prohibiting all deficiency judgments would be preempted, because it would eliminate the possibility of recovering from the veteran. Id. at 1368-69; see also *Connelly v. Derwinski*, 961 F.2d 129, 130 (9th Cir.1992) (Oregon foreclosure procedure forbidding any deficiency judgment preempted); *Shepherd v. Derwinski*, 961 F.2d 132 (9th Cir.1992) (same for Arizona). At the same time, however, *Whitehead* significantly restricted the scope of this indemnity right by holding the right of subrogation was primary, while the right of indemnity was merely a backstop. 904 F.2d at 1369. So long as the state provided at least one foreclosure route that offered a possibility of a deficiency judgment--even if it made foreclosure more burdensome or costly--the VA's right of subrogation was fully protected and the state scheme wasn't preempted. Id. at 1371.

The district court held that Whitehead controlled this case. In Idaho, as in Washington, the VA could have instructed lenders to foreclose judicially; moreover, unlike in Washington, the Idaho lenders could also have preserved their right to a deficiency judgment by obtaining a fair market valuation within three months of nonjudicial foreclosure. The VA therefore forfeited its right to

proceed against the veterans by way of indemnity. Under *Whitehead*, we would have to affirm the district court's judgment. B. Whitehead 's central assumption--that the VA's right of indemnity is secondary to its primary right of subrogation--warrants scrutiny. The relevant statute provides that "[i]n the event of default ... the Secretary shall be subrogated to the rights of the holder of the obligation to the extent of the amount paid on the guaranty." 38 U.S.C. s 3732(a)(1). Although the statute itself only mentions subrogation, the regulation implementing it also gives the Secretary a right of indemnity: (a) The Secretary shall be subrogated to the contract and the lien or other rights of the holder to the extent of any sum paid on a guaranty or on account of an insured loss.... (e) Any amounts paid by the Secretary on account of the liabilities of any veteran ... shall constitute a debt owing to the United States by such veteran. 38 C.F.R. s 36.4323 (emphasis added).

Consistent with this regulation, courts have repeatedly held that the VA has a right of indemnity. In *United States v. Shimer*, 367 U.S. 374, 81 S.Ct. 1554, 6 L.Ed.2d 908 (1961), the Supreme Court considered whether a Pennsylvania statute, which prohibited deficiency judgments until a state court valuation of the property was obtained, was inconsistent with regulations governing the calculation of the amount of guarantee the VA pays the lender. The veteran argued that, because the statute provided only for subrogation, the VA couldn't seek a deficiency judgment against him outside the state law procedure. *Shimer* flatly rejected this contention: "[T]he statute affords an independent right of indemnity to the Veterans' Administration." Id. at 387, 81 S.Ct. at 1563.[1]

---

[1]The veterans suggest that *Shimer* is no longer good law in light of modern developments in federal preemption doctrine. Appellee's Supplemental Brief at 6. The Supreme Court apparently still thinks *Shimer* is good law, see, e.g., *City of New York v. FCC*, 486 U.S. 57, 64, 108 S.Ct. 1637, 1642, 100 L.Ed.2d 48 (1988); *Capital Cities Cable, Inc. v. Crisp*, 467 U.S.

While *Whitehead* recognized that the Secretary has both a right of indemnity and a right of subrogation, 904 F.2d at 1364-67, it nonetheless assumed the right of indemnity was secondary to the right of subrogation: "The VA's primary right against the debtor is the statutory right to subrogation. When a state antideficiency law precludes collection by way of subrogation, the VA may exercise its independent indemnity right, which displaces the effect of state law." Id. at 1369. *Whitehead* construed the right of indemnity to be merely a surrogate for the right of subrogation, available only when subrogation was impossible, i.e., in those states that prohibit all deficiency

---

691, 700, 104 S.Ct. 2694, 2701, 81 L.Ed.2d 580 (1984), and we are in no position to disagree. Cf. *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484, 109 S.Ct. 1917, 1921-22, 104 L.Ed.2d 526 (1989) ("If a precedent ... has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, the Court of Appeals should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions.") We recently declined a similar invitation to limit Shimer: "The veterans argue that Shimer is no longer good law. We reject this argument." *Connelly v. Derwinski*, 961 F.2d 129, 131 n. 1 (9th Cir.1992). Other circuits also continue to follow Shimer. See, e.g., *United States v. Davis*, 961 F.2d 603, 609-10 (7th Cir.1992); *Vail v. Derwinski*, 946 F.2d 589, 590 (8th Cir.1991). In addition, the veterans point out that *Shimer* involved a different regulation, 38 C.F.R. s 36.4320, which deals with the calculation of the amount of guarantee the VA must pay the lender. They claim this is significant because *Shimer* involved the relationship between the VA and lenders, whereas this case involves the relationship between the VA and veterans. But *Shimer* was an indemnity action by the VA directly against the veteran. Moreover, the Court's square holding--that the regulation provides an independent right of indemnity against the veteran--is directly applicable to this case.

judgments.[2] So long as the VA could instruct lenders to foreclose in a way that would protect the lender's right to collect a deficiency judgment, the VA's "primary" right of subrogation would be preserved, rendering the indemnity right unnecessary. Whitehead framed the issue as involving a "choice of remedy," id. at 1368; when the VA elects foreclosure that interferes with or prohibits its indemnity right, it's bound by that decision. Thus, in a state like Washington or Idaho,

> [b]ecause the VA directs the lender's choice between the two methods available ... it is in complete control of its ability to be made whole. Given the availability of the judicial foreclosure alternative, which allows the VA to exercise its primary right to subrogation and proceed directly against the debtor, the VA may not choose the non-judicial foreclosure alternative, and then resort to its right to indemnity. Id. at 1369.

This rationale has intuitive appeal. It seems fair to recognize the quid pro quo involved in the use of nonjudicial foreclosure. If the VA wishes to avoid judicial foreclosure, which tends to be debtor-friendly, it should have to abide the consequences of that decision under state law.

But this approach is not consistent with the regulations as written by the VA and as interpreted by the Supreme Court in Shimer. The regulation, 38 C.F.R. s 36.4323, says the VA has the right of both subrogation and indemnity; it says nothing about

---

[2]A state law that permitted foreclosures generally, but prohibited or restricted them in some cases--for example, barred deficiency judgments against property worth less than $40,000--would also be preempted. The effect would be the same in either state: The lender, and thus the VA, would be unable to preserve its right to a deficiency judgment against some veterans, no matter how diligently the lender complied with state foreclosure law.

the right of indemnity being available only if the VA can't fully recover through subrogation. The regulation doesn't rank the rights of subrogation and indemnity, nor express a preference for one over the other; the two rights are set out in parallel provisions with no indication that one is dependent or conditioned on the other. The words "primary" and "secondary" are nowhere to be found in the regulation. Indeed, the regulation is captioned simply, "Subrogation and indemnity." The only reasonable conclusion we can reach from reading the regulation is that the right of indemnity stands on equal footing with the right of subrogation. This conclusion is not altered by the fact that we deal here with an administrative regulation rather than a statute: "[P]roperly promulgated, substantive agency regulations have the 'force and effect of law.' " *Chrysler Corp. v. Brown*, 441 U.S. 281, 295, 99 S.Ct. 1705, 1714, 60 L.Ed.2d 208 (1979).

Nor does it matter that the VA has, by choosing nonjudicial foreclosure, essentially been able to secure the benefits of nonjudicial foreclosure with none of the drawbacks. The VA is not a private litigant, limited to the choices provided by state law; it's an arm of the federal government and cannot be deprived of the benefits of federal law, regardless of any election it may make under state law. Federal law is mandatory, and neither the State of Idaho through legislation, nor the VA through its litigation choices, can waive its applicability. Cf. *Adams Fruit Co. v. Barrett*, 494 U.S. 638, 646, 110 S.Ct. 1384, 1389, 108 L.Ed.2d 585 (1990) ("We likewise reject petitioner's contention that, where Congress authorizes a private right of action to vindicate a federal right, we should assume that Congress has conditioned that right on the unavailability of a state remedy.")

We are not free to pick and choose among statutory or administrative provisions in order to achieve a result we deem fair or sensible. We may, as a matter of legislative interpretation, place a gloss on vague or undefined terms. See, e.g., *Monell v. Department of Social Servs.*, 436 U.S. 658, 98 S.Ct. 2018, 56 L.Ed.2d 611 (1978) (a municipality is a "person" within the meaning of 42 U.S.C. s 1983). Congressional silence may, from

time to time, require us to fill gaps within the interstices of a statute. See, e.g., *J.I. Case Co. v. Borak*, 377 U.S. 426, 84 S.Ct. 1555, 12 L.Ed.2d 423 (1964) (shareholders have cause of action to sue for violation of s 14(a) of Securities Exchange Act of 1934). We may insist on a clear statement of congressional intent before interpreting a statute in a way that compromises especially weighty values. See, e.g., *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 243, 105 S.Ct. 3142, 3147-48, 87 L.Ed.2d 171 (1985) (Congress must unequivocally express its intent to abrogate states' Eleventh Amendment immunity). Likewise, we may construe a statute narrowly when its literal reading seems inconsistent with the Constitution. See, e.g., *Eastern R.R. Presidents Conference v. Noerr Motor Freight*, 365 U.S. 127, 137-38, 81 S.Ct. 523, 529-30, 5 L.Ed.2d 464 (1961) (Sherman Act interpreted to exempt lobbying for commercial advantage in order to avoid potential conflict with right to petition government). And, in rare cases, the asserted justification for a regulation may be so far afield from the agency's assigned mission that we discard our usual presumption that an agency actually relies upon its stated reason when adopting a rule. See *Hampton v. Mow Sun Wong*, 426 U.S. 88, 104- 05, 96 S.Ct. 1895, 1905-06, 48 L.Ed.2d 495 (1976).

This case falls under none of these rubrics. The regulation at issue plainly says the VA has a right of both subrogation and indemnity. There is no occasion for us to resolve any conflict between the exercise of these two rights, because both can be fully enforced. Indeed, not only are the rights of subrogation and indemnity not in conflict, they are complementary and mutually reinforcing. Demoting the right of indemnity to second-class status amounts to a judicial rewriting of the regulation.
Whitehead 's construction of the regulation--that the right of indemnity is relevant only when the state bans all deficiency judgments-- relegates the provision to near-total irrelevance. In any state like Idaho, if the VA wishes to seek a deficiency it must foreclose judicially or else comply with additional procedural obligations. And in a state like Washington, the choice is even more stark because the VA has only one option--judicial

foreclosure--that will retain its right of indemnity[3]. If the VA doesn't elect judicial foreclosure it sacrifices forever the regulation's guarantee that it can proceed directly against the veteran. While Whitehead phrased the issue as merely a "choice of remed[ies]," 904 F.2d at 1368, the imposition of such an artificially forced choice is inconsistent with federal law, which gives the VA the right to avail itself of both remedies.

Whitehead's central assumption has been examined and rejected by two other circuits. *United States v. Davis*, 961 F.2d 603 (7th Cir.1992), considered whether Wisconsin's foreclosure scheme, materially identical to Idaho's, was preempted. After first recognizing the existence of a federal indemnity right that didn't depend on state subrogation or foreclosure law, id. at 608, the court rejected the argument that the VA had forfeited its indemnity right by instructing lenders to proceed by way of nonjudicial foreclosure. "Simply because the VA could have instructed lenders to proceed [with judicial foreclosure], and arguably preserved its subrogation rights, does not provide us authority for insisting that it take that course of action." Id. at 609. Unable to find any support for "forc[ing] the VA to privilege its subrogation right over its indemnification right," id., the court permitted the VA to recover from the veteran. In so holding, the Seventh Circuit considered and declined to follow Whitehead. Id. The Eighth Circuit reached a similar conclusion. See *Vail v. Derwinski*, 946 F.2d 589, 591 (8th Cir.1991) ("[W]e cannot agree with the *Whitehead* premise that when the state provides dual foreclosure procedures the judicial foreclosure

---

[3]Curiously, under *Whitehead* the VA is better off in a state like California which, in the case of single family dwellings, entirely prohibits deficiency judgments on notes secured by purchase money mortgages. See Cal.Code Civ.Proc. s 580b; see also *United States v. Rossi*, 342 F.2d 505, 506 (9th Cir.1965) (California prohibition on deficiency judgments preempted by VA regulations).

procedure is primary and the nonjudicial procedure is secondary. No rationale exists for this conclusion."); see also *Boley v. Principi*, 144 F.R.D. 305 (E.D.N.C.1992) (also rejecting *Whitehead*).

Whitehead's assertion that the VA's indemnity right plays second fiddle to its subrogation right was unsupported and, we conclude, unsupportable. We join the Seventh and Eighth Circuits and hold that *Whitehead* was incorrectly decided; accordingly, we overrule it.

C. The application of the foregoing principles to this case is straightforward. The district court, relying on *Whitehead*, held that the VA's ability to recover from the veterans was limited by its election (through the lenders) of nonjudicial foreclosure. As we have said, the VA retains an independent right to recover directly from the veterans any sums it pays lenders. The district court therefore erred in granting the veterans' motion for summary judgment, and for the same reasons erred in denying the VA's cross- motion.

We need not decide whether the Idaho foreclosure scheme is preempted. Whether and under what circumstances the state deficiency procedures might produce a lesser recovery than an action on the federal indemnity right isn't pertinent. Such analysis incorrectly assumes that the VA must comply with the state scheme in order to recover from the veterans. Regardless of the method by which a lender proceeds against a defaulting veteran--even when it does so at the VA's direction--the VA always possesses a right of indemnity against the veteran for the amount of guarantee paid to the lender. This is an independent right of indemnity, created by federal law, which state courts must honor. See *McKnight v. United States*, 259 F.2d 540, 544 (9th Cir.1958) (indemnity actions by VA "arise[ ] under the federal law and cannot be impaired by a state statute"); see also *Testa v. Katt*, 330 U.S. 386, 67 S.Ct. 810, 91 L.Ed. 967 (1947) (state courts must entertain federal causes of action). Because this federal indemnity right doesn't depend on state foreclosure or

deficiency law, preemption analysis is unnecessary. "[T]he VA's right to indemnity derives from a contract independent of the mortgage. As indemnitor the veteran is in the same position as the guarantor: accordingly ... [the state] law does not impair the VA's right of indemnification and ... there is no need for finding federal preemption." *Vail*, 946 F.2d at 592. State laws which affect lenders' ability to recapture additional amounts from veterans after foreclosure therefore do not affect the VA's independent right to seek recovery from veterans. Those laws are not preempted by federal law; they are simply irrelevant.

Conclusion

The district court's orders denying the VA's motion for summary judgment and granting the veterans' motion for summary judgment are each REVERSED; the case is REMANDED for further proceedings consistent with this opinion; and *Whitehead v. Derwinski*, 904 F.2d 1362 (9th Cir.1990), is overruled.

BEEZER, Circuit Judge, with whom Circuit Judges HUG, FLETCHER and BRUNETTI join, dissenting:

Because I conclude the VA may not recover amounts paid on its guaranty after the VA authorizes the veteran's release from liability, I would affirm the district court's order enjoining the VA's collection activities and compelling the return of funds impermissibly collected.

I.

An eligible veteran may obtain a loan secured by residential property from a private lender that is guaranteed by the VA. The VA is a compensated guarantor. 38 U.S.C. s 3729. If the veteran defaults on the loan, the VA, as guarantor, may pay losses sustained by the lender as determined under VA regulations. 38 C.F.R. s 36.4321. The regulations require the lender to notify the VA before foreclosing and to allow the VA to instruct the lender on how to proceed. 38 C.F.R. ss 36.4317, 36.4324(f)(2). If the

lender releases the veteran from liability without the VA's prior approval, the VA is generally released from liability on its guaranty. 38 C.F.R. s 36.4324(f). State law governs any foreclosure. 38 U.S.C. s 3720(a)(6); 38 C.F.R. ss 36.4319, 4320.

Each plaintiff Idaho veteran purchased residential real property with a VA guaranteed loan. The loan became delinquent in repayment and was in default. At the VA's direction, the lender initiated a non-judicial foreclosure. The lender did not seek a deficiency judgment within the three month period set forth under Idaho law. Idaho Code (IC) s 45-1512. The VA could have instructed the lender to foreclose judicially and seek a deficiency judgment. IC ss 6-101; 45-1503. A deficiency judgment would have fixed the amount of remaining liability, if any, to be imposed upon the veteran after foreclosure. IC ss 6-108, 45-1512. Under Idaho law, failure to obtain such a judgment after foreclosure bars action to collect any asserted debt relating to the loan. *Frazier v. Neilson & Co.*, 769 P.2d 1111, 1114 (Idaho 1989).

The amounts paid by the VA pursuant to its guaranty gave rise to a statutory subrogation to the lender's causes of action against the veteran. 38 U.S.C. s 3732(a)(1). If the lender had obtained a deficiency judgment, this subrogation right would have allowed the VA to attempt collection from the veteran. Instead, the VA asserted a federal right of indemnity and began various collection activities against the veteran.

II.

In *United States v. Shimer*, 367 U.S. 374, 386-88, 81 S.Ct. 1554, 1562-63, 6 L.Ed.2d 908 (1961), the Supreme Court emphasized the role that equitable principles of surety law play in defining the VA's recovery rights and at no point indicated that the recovery rights extend beyond their equitable underpinnings. Shimer simply does not stand for the inequitable proposition that

the VA may recover amounts paid on its guaranty after authorizing the veteran's release from liability.

Although the VA's rights of recovery by way of subrogation and indemnity may, in some sense, have equal footing, the rights certainly stand on different ground. The subrogation right works as an equitable assignment of the lender's claims, with the VA taking any such claims subject to defenses of the veteran. Laurence P. Simpson, Handbook on the Law of Suretyship 211 (1950); Restatement of the Law of Security s 141. Thus, recovery under the subrogation right may be defeated by operation of law if, for example, the statute of limitations bars recovery.

In Shimer, the Court stated that the indemnity right flows from the "ordinary concomitants of a guaranty relationship" and that 38 C.F.R. s 36.4323(e) is "merely declaratory of a surety's customary right of indemnity." 367 U.S. at 386, 387-88, 81 S.Ct. at 1562-63. As such, the indemnity right is rooted in the equitable concept that direct recovery by the VA may prevent unjust enrichment of the veteran. *Simpson*, supra, at 225- 26. The indemnity right thus is generally unaffected by defenses of the veteran that are not available to the VA. *Simpson*, supra, at 227. For instance, the VA may recover under the indemnity right even though the veteran has been discharged by operation of law. Id. Under surety law, if the VA consents to the veteran's release from liability, the VA retains its liability on the guaranty and loses its rights of subrogation and indemnity from the veteran. *Simpson*, supra, at 301. Manifest inequities would result if the VA could consent to the veteran's release from liability yet retain recovery rights. As occurred here, the VA would be free to decide when it was advantageous to determine a deficiency without involvement of a court or the veteran, pay that self-determined deficiency, and be made whole on a full recovery from the veteran.

Nothing in *Shimer* detracts from the equitable principles that govern the VA's rights of recovery. The Supreme Court does not say that the VA may recover after authorizing the veteran's release from liability. Moreover, the rights of recovery outlined in Shimer allow the VA to control its losses. In a state like California, which prohibits deficiency judgments, the lender's deficiency claim is barred by operation of law upon foreclosure.

The VA, with no opportunity to recover through subrogation and not having consented to the veteran's release from liability, may still recover under the indemnity right. *Simpson*, supra, at 231. In states like Idaho that allow deficiency judgments, the VA may instruct the lender to seek such a judgment and recover under the subrogation right. The indemnity right permits recovery if the VA retained liability even though the lender released the veteran from liability without the VA's prior approval. See 38 C.F.R. s 36.4324(f)(2). If the VA instructs the lender to release the veteran from liability, however, the VA waives the subrogation and indemnity rights and may not recover amounts paid on its guaranty.

Because here the VA authorized release from liability, the veteran has no obligation to reimburse the VA. The VA directed the foreclosure and does not contend that the veteran was released from liability without its prior approval. In these circumstances, nothing in s 36.4323(e), or the principles of suretyship that support the VA's rights of recovery, permit the VA to recover amounts paid on its guaranty.